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STAGGERS RAIL ACT OF 1980

HEARINGS

BEFORE THE

SUBCOMMITTEE ON SURFACE TRANSPORTATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

OVERSIGHT OF THE STAGGERS RAIL ACT OF 1980

JULY 26, 27, AND SEPT. 1, 1983

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STAGGERS RAIL ACT OF 1980

TUESDAY, JULY 26, 1983

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., Hon. John C. Danforth (chairman of the subcommittee) presiding.

Staff members assigned to these hearings: Pamela Garvie and Chuck Doyle, staff counsels; and Linda Morgan, minority staff counsel.

OPENING STATEMENT BY SENATOR DANFORTH

Senator DANFORTH. This morning the Surface Transportation Subcommittee is holding the first of 2 days of oversight hearings on the Staggers Rail Act of 1980. When Congress passed this act, its goals were, one, to improve the economic health of the railroad industry; two, to insure effective competition; and three, to protect shippers through regulation in the absence of effective competition.

The purpose of these hearings is to determine whether the goals of Congress are being met. The hearings will focus on, one, railroad profitability; two, coal rates and the Interstate Commerce Commission's implementation of the act's provisions dealing with captive shippers; three, joint rate cancellations; and four, the ICC's decisions to exempt from regulation the transportation of traffic moving in box cars and the transportation of coal moving for export.

The subcommittee will be receiving oral testimony from a number of different witnesses on these subjects and others. These witnesses include representatives of the administration and the ICC, the railroad industry, numerous shipper groups and equipment lessors. I would also like to invite other interested individuals and groups to submit written statements for the committee's hearing record. The record will be open for 2 weeks after the hearing.

Senator Hollings has an opening statement which will be placed in the record.

[The statement follows:]

OPENING STATEMENT BY SENATOR HOLLINGS

Today the Surface Transportation Subcommittee begins 2 days of oversight hearings on the implementation of the Staggers Rail Act of 1980, which clearly represents one of the most significant pieces of rail legislation passed in the last several years. Committee members will examine how the rail industry and the shipping public have fared since the passage of the act and whether the intent of the act has been carried out.

The passage of the Staggers Act was motivated by a growing concern with the financial decline of the rail industry and the threat to its continued long-term viability in the private sector. After numerous hearings on this issue, the committee determined that unnecessary regulation had prevented the rail industry from being able to adequately adapt to the changing transportation marketplace. Thus the act provided the industry with the flexibility appropriate and necessary to so adapt, and to offer good-quality service. At the same time, however, the act was intended to retain regulatory protection where market forces are not adequate to ensure continued service at reasonable rates.

The act thus represents a delicate balance between Congress' interest in the revenue adequacy of the rail industry and the need to maintain regulation for the so-called captive shippers. The Interstate Commerce Commission was vested with the task—indeed a difficult one—of effectuating this balance.

The subcommittee will be receiving much, and indeed conflicting, testimony on whether the Commission has carried out this intent, particularly with respect to rate regulation. Specifically, we will be examining difficult issues relating to the Commission's determinations of revenue adequacy and market dominance, rail costing, the application of the important Long-Cannon factors to be used in determining rate reasonableness, the use of the Commission's exemption authority, and the growing problem of route cancellations.

I might mention in this regard the legislation introduced by my colleague Senator Ford which addresses some of these issues, and I look forward to working with him and all interested parties as we strive to ensure that the intent of the Staggers Act is being met and that our rail transportation sector is strong.

Senator **Danforth**. Senator Gorton, do you have a statement?

Senator **Gorton**. No.

Senator **Danforth**. Senator Pressler.

Senator **Pressler**. Yes, I do.

OPENING STATEMENT BY SENATOR PRESSLER

Senator **Pressler**. Mr. Chairman, I do have a brief statement. As you know, I opposed the deregulation of our railroads when this issue was before our committee 3 years ago. As a farm State Senator from South Dakota, I was especially concerned about its impact on rural America and consumers in general. Since passage of the Staggers Deregulation Act, I have seen numerous railroad abandonment proceedings in my home State.

As we discuss this issue this morning, a nearly 200-mile line in South Dakota is being considered for abandonment. We have experienced soaring railroad transportation prices, declining grain prices, increasing rail-related business closures, and a growing mistrust of the U.S. Government.

Mr. Chairman, I still oppose railroad deregulation. While I realize that all the things that have been mentioned are not solely due to railroad deregulation, it has undoubtedly contributed to these problems a great deal, especially in rural States like South Dakota.

In South Dakota we do not have the giant corporations or the huge coal mining interests that can own and operate their own railroad, but we do have thousands of farmers and small businessmen who depend heavily on at least some type of minimal railroad service for their very survival. Unfortunately, as I indicated earlier, railroad deregulation has made it impossible for them simply to survive in many cases.

This is unfair to rural States that depend heavily on the railroads for their livelihood but do not have the marketing clout to keep them operating.

Our national railroad network was a joint venture between private industry and the U.S. Government to provide transportation and service to all Americans, rural or urban, rich or poor, small businessmen or huge conglomerates. That important point should not be forgotten as we continue in our discussions today. Over the last 3 years, I am afraid it was to a great extent.

It is important that we insure some type of minimum standard of service for all those users. Since the Staggers Act was passed I believe we have lost sight of any previous standard, especially in rural and small town America. It is time we found it back.

I urge this committee to begin its efforts to reestablish that type of standard with proper attention given to all regions of the country.

Thank you, Mr. Chairman. And Mr. Chairman, I have several questions, but I have to chair another hearing this morning. I will be back and forth. If I am not here, I would ask that the questions be asked at least for the record.

Senator **Danforth**. Fine.

Senator Ford.

OPENING STATEMENT BY SENATOR FORD

Senator **Ford**. Mr. Chairman, let me thank you in the beginning for allowing me to participate. I am not a member of the subcommittee, but I am a member of the full committee.

I want to commend the chairman of the Surface Transportation Subcommittee for calling the hearing. This is an excellent time to assess the effectiveness of the Staggers Act. I, and others at the table, recall full well the debate in 1980 on rail legislation. Of course, I was sitting on that side of the table at that time, and now I am on this side of the table, but my interest is still the same.

Maybe in the near future I will be able to get back on that side over there, John. You just hold on, we will be there shortly.

In 1980 the railroads were suffering from regulatory suffocation. There was a need for pricing freedoms on the commodities where there was competition. During the debate of the Staggers Act many Members of the Senate worked to strike a balance between the revenue interests of the railroads and those of coal and other captive shippers by retaining an appropriate degree of rate regulation.

The coal shippers in eastern Kentucky are today no less captive than they were before the passage of the Staggers Act. In fact, today they are even more vulnerable to escalating coal rates since the intent of Congress has been ignored—and I underscore "has been ignored"—and the ICC has virtually granted unlimited pricing freedoms for coal movements and has left captive coal shippers with little recourse before the Commission.

Captive shippers are not getting the protection they need and what Congress intended.

In a series of decisions, the ICC has treated revenue adequacy as virtually the sole consideration in determining rate reasonableness. The Long-Cannon factors which were hammered out in this committee room have been ignored. One recent decision of the ICC raises the question of whether railroad export coal rates will rise to the point that the delivered price of America's coal will be so high as to lose a portion of the U.S. share of the world coal market.

I am anxious to question the Commissioners of the ICC on these issues.

Mr. Chairman, I have no quarrel with the Staggers Act. My disappointment is directed at the ICC. Since the passage of the Staggers Act, the railroads have rebuilt their marketing strength due to ratemaking flexibility. I am especially pleased with the ability of coal operators and utilities to enter into a long-term contract.

Recently I introduced legislation to help remedy some of the problems as created by the ICC. This bill, S. 1082, does not go further than the Staggers Act. It only enhances the intent of Congress, especially in the area of market dominance.

Since the ICC has attempted to devise standards for market dominance since the passage of the 4R Act in 1976, it is high time that the Congress spells out the approach for determining market dominance.

I noticed, Mr. Chairman, in a briefing paper being distributed by the railroads regarding my bill, S. 1082, that its passage would return the industry to a regulatory era as it existed prior to World War I. I have been told that I am behind the times. I have been told that before, by the way, but I was never told that I was as far back as 1914. It is hoped a discussion of some of the provisions of S. 1082 will prove to its opponents that I am at least coming to the modern age. And if some of them who oppose my bill do not believe it, well, just hang on.

Thank you, Mr. Chairman.

Senator DANFORTH. Senator Exon.

OPENING STATEMENT BY SENATOR EXON

Senator EXON. Mr. Chairman, I have no prepared statement. I just want to make a point or two, and then we can proceed as far as we are concerned on this side.

As a member of this committee that worked very hard on the so-called deregulation of the railroads, the Staggers Act, I voted for that with some reservations that I clearly enunciated at that time. I am fearful that the concerns that I had at that time have now come home to roost. Therefore, I am very pleased that the chairman of the subcommittee has called these hearings, and I think that they could not come at a better time. I believe that indeed it is the responsibility of the Congress to see whether or not the intent of Congress in that rail deregulation act is being carried out by the ICC.

It is my perception at this time that they are not handling the captive shipper part of that bill as we had intended and as we discussed at great length not only in this committee but on the floor when the bill was passed.

Therefore, I am going to be listening with keen interest to the testimony of the distinguished panels that will be before us today. I would certainly say that the railroads have an opportunity today to make their case.

The railroad industry knows quite well the standing of this Senator from a very rural State, primarily concerned about captive shippers with regard to movement of grain, primarily concerned about captive shippers who are dependent upon coal. While I think that we should first recognize that in passing the act we tried very hard to give freedom to the railroads and to allow them to make some money because they play such a vital part in our overall transportation system, at the same time things have come to my attention that have not been explained to me such as to why rates have gone up as they have in certain sections of the country, particularly with regard to commodities that I have mentioned, and others.

I would also say to those assembled here that while this Senator is opposed now, and will always be in the future, to coal slurry pipelines, and while this is not a hearing on coal slurry pipelines, that issue plays into this whole matter of transportation and the health of the railroad industry. I think that this Senator, like all of us on this committee, is concerned about the health of the railroads. We expect fairness, above everything else, to those who want to make money under the free enterprise system.

I have some reservations about how this act is being interpreted by the ICC. My mind remains somewhat open on this, but I think that all of us can learn from these hearings. And then once we learn, it is our responsibility to take the necessary steps that might be necessary to correct anything that is happening in the Federal bureaucracy that was not intended by the committee or by the Senate.

Senator **Danforth**. Thank you, Senator Exon.

Senator Warner, we are glad to have you with us.

STATEMENT OF HON. JOHN W. WARNER, U.S. SENATOR FROM VIRGINIA

Senator **Warner**. Thank you, Mr. Chairman. It is a pleasure to return once again to this committee at which I shall always carry with pride my participation as alumnus.

I am reassured by the opening statements of my colleagues that you perceive the problem very much as I do, and therefore, Mr. Chairman, I would like to submit my entire statement and perhaps just make a few introductory remarks, and enable the panel then to get on with the witnesses.

I am pleased that having written you and asked for these hearings, that you went ahead and scheduled them. I am concerned, as are other Members of the Senate, that in a few very important instances the implementation of the Staggers Act by the ICC is not meeting some of the major goals of the act as envisioned by Congress.

In 1980, as a member of this distinguished committee, I strongly supported and voted for the Staggers Rail Act of 1980. I believed that it would, among other things, eliminate unnecessary and excessive regulation of the railroad industry, improve the financial health of the railroad, allow the use of railroad transportation contracts and preserve a reasonable degree of captive shipper protection.

My support for the act was given only after a very careful balance was struck in this committee between providing financial health to the railroads and insuring that adequate safeguards were in the act to protect captive shippers from unreasonable economic harm. Debate in the committee on this issue focused on the problems of the captive shipping coal producer. America and the world had just suffered a major energy disruption which had brought about economic instability. All energy-dependent parties were looking to America's coal as the answer to their energy plight and as a means to avoid future economic blackmail from foreign energy curtailments.

To disregard the balance between railroads and captive shippers would, in my judgment, blunt America's drive toward energy independence, unreasonably increase the cost of America's coal for domestic and international consumption, driving consumers away from this vital alternative fuel; put enormous numbers of coal miners out of work, bringing economic hardship to producing regions; and adversely affect America's balance of payments and international trade.

In the act, Congress established a specific rail transportation policy to guide the ICC in its duties to regulate the railroad industry. The conference report on the Staggers Act states, and I quote, "The Conferees intend that this policy include the encouragement and promotion of the transportation of coal by rail in accordance with the objective of energy independence at rates that do not exceed a reasonable maximum where there is an absence of effective competition."

As one of its five stated goals, the Staggers Act is to "provide a regulatory process that balances the needs of carriers, shippers, and the public."

It appears that recent ICC actions, namely, the exemption of export coal from regulation and the ICC's proposed coal rate guidelines, may upset the act's goal of balancing the needs of interested parties and ignore Congress specific mandate to maintain reasonable rates where there is an absence of effective competition.

I join with my colleagues in framing those issues. I wish you well, and I look forward with great interest to the resolution of those questions.

[The statement follows:]

STATEMENT OF HON. JOHN W. WARNER, U.S. SENATOR FROM VIRGINIA

Mr. Chairman, I would first like to commend you for holding these timely oversight hearings on the Staggers Rail Act of 1980.

In response to recent actions taken by the Interstate Commerce Commission under the Staggers Act, I wrote the Chairman of the Senate Commerce, Science, and Transportation Committee requesting oversight hearings on the Act's implementation.

Your letter to me announcing the hearings indicates that their purpose is to look at whether the goals of the Staggers Act are being met.

I am concerned that in a few very important instances, implementation of the Staggers Act by the I.C.C. is not meeting some of the major goals of the act as envisioned by Congress.

In 1980, as a member of the Commerce Committee, I strongly supported and voted for the Staggers Act of 1980, believing that it:

(1) Eliminated unnecessary and excessive regulation of the railroad industry;
(2) Improved the financial health of the railroads;
(3) Allowed for the use of railroad transportation contracts;
(4) Preserved a reasonable degree of captive shipper protection.

My support for the Staggers Act was given only after a very careful balance was struck in Committee between providing financial health to the railroads and insuring that adequate safeguards were in the Act to protect captive shippers from unreasonable economic harm.

Debate in Committee on this issue focused on the programs of the captive shipping coal producer. America and the world had just suffered a major energy disruption which had brought about economic instability. All energy dependent parties were looking to America's coal as the answer to their energy plight and as a means to avoid future economic blackmail from foreign energy curtailments.

To disregard the balance between railroads and captive shippers would:

Blunt America's drive towards energy independence,

Unreasonably increase the cost of America's coal for domestic and international consumption driving consumers away from this vital alternative fuel,

Put enormous numbers of coal miners out of work bringing economic hardship to the coal producing regions, and

Adversely affect America's balance of payments and international trade.

In the Act, Congress established a specific rail transportation policy to guide the I.C.C. in its duties to regulate the railroad industry. The Conference Report on the Staggers Act says—and I quote:

"The Conferees intend that this policy include the encouragement and promotion of the transportation of coal by rail in accordance with the objective of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition."

As one of its five stated goals, the Staggers Act is "to provide a regulatory process that balances the needs of carriers, shippers, and the public."

It appears that recent I.C.C. actions, namely the exemption of export coal from regulation and the I.C.C.'s proposed coal rate guidelines, may upset the Act's goal of balancing the needs of interested parties and ignore Congress' specific mandate to maintain reasonable rates where there is an absence of effective competition.

The two I.C.C. decisions may result in reduced use of coal, putting miners out of work, and increasing the coal industry's economic hardship—exactly what Congress did not intend when it passed the Act.

In its written decision implementing the exemption from regulation of coal export rates, the I.C.C. implies that the balancing test of the Act has been met and there will be no harm to either party because "it simply is not reasonable to forecast a decrease in the amount of coal exported."

And yet, in making this statement, the I.C.C. ignored its own environmental assessment which projected if rail transportation costs are increased, Virginia, Utah and Colorado will experience a dramatic or complete loss of all export production by 1985 as a direct result. Moreover, it indicates that by 1990, a substantial decline in coal productivity will occur in West Virginia, Alabama, and Oklahoma, and by 1995, New Mexico will lose its entire export coal market, assuming rail rates increased under the I.C.C. decision.

A soon-to-be-published report of the Energy Information Administration (EIA), the independent statistical and analytical Agency within the U.S. Department of Energy, entitled "Railroad Deregulation: Impact on Coal" finds that:

"The projected rail rate increases have the effect of slowing down the rate of growth indicated for U.S. coal exports . . . In the more extreme rail rate increase cases, the level of U.S. coal exports is actually reduced . . . Even though railroads haul smaller tonnages, their revenues rise as a result of the rate increases; however, the coal industry registers larger revenue losses with the result that total U.S. coal export revenues decline."

Mr. Chairman, in 1981, U.S. coal exports generated $5.9 billion in revenues, which represented 2.5 percent of total U.S. export revenues and more than 57 percent of U.S. energy export revenues.

The EIA forecasts that U.S. coal exports—because of recent I.C.C. rate actions—will decline by 14.9 million short tons in 1985 from that predicated under rate regulation, 27.2 million short tons in 1990 and 36.6 million short tons in 1995.

Finally, in 1995, the EIA forecasts that the I.C.C. exemption of coal export rates will generate a $463.6 million increase in revenues for the railroads and a $1,932.2 million loss for the coal industry.

Upon reading the EIA assessment one can conclude that the balance Congress was seeking in passing the Staggers Rail Act was dramatically tilted by the recent I.C.C. decision.

Seventy-thousand American coal miners are out of work, and the U.S. is already losing coal export markets. A recent U.S.-European conference announced that seven million tons of coal sales had been lost this year because of high railroad rates. This tilted scale cannot be permitted to continue, or all of America will suffer.

I would strongly suggest that the I.C.C., based upon the recent EIA study and the current international market forces at work in the export coal trade, reexamine its decision on the deregulation of export coal rates and give serious consideration to implementing the balance Congress sought in passing the Staggers Act to provide needed protection for captive coal shippers.

I want to include for the record a copy of my most recent correspondence from the Honorable Preston Shannon, Chairman of the State Corporation Commission, regarding Virginia's efforts to obtain certification to regulate intrastate rail rates. I have been working on this issue for several years and anticipate it will soon be resolved.

Mr. Chairman, I commend you for holding these hearings and will look forward to the Commerce Committee's conclusions about the impact on the coal and the rail industries of the I.C.C.'s implementation of the Staggers Act.

Attachment.

COMMONWEALTH OF VIRGINIA,
STATE CORPORATION COMMISSION,
Richmond, Va., July 1, 1983.

Hon. JOHN W. WARNER,
Member, U.S. Senate, 405 Russell Senate Office Building, Washington, D.C.

DEAR SENATOR WARNER: This letter is in further reference to the difficulties being experienced by Virginia, as well as all States, in obtaining unconditional certification under Section 214 of the Staggers Rail Act of 1980. As I am sure you will recall, I sent a letter to the Virginia congressional delegation, a copy of which is attached for your reference, expressing my extreme displeasure with the Interstate Commerce Commission's (ICC's) implementation of Staggers. I am unhappy to report that Virginia is no closer to permanent certification now than it was over 2½ years ago.

My question is quite simple and should be easily answerable: When the United States Congress directs an administrative agency to act within certain time limits, why can't that agency act in a prompt and efficient manner? The ICC is required under Staggers to act on a State's request for certification within 90 days after the submission of the states' standards and procedures to implement the Act. The ICC has consistently ignored congressional mandate throughout the entire certification process. It has been almost 3 years since Staggers was signed into law and not one state has obtained permanent unconditional certification.

The certification of Virginia is an issue of vital importance to the Commonwealth. If Virginia is not certified, it will lose all jurisdiction over the intrastate rates of railroads operating within Virginia. If this occurs, all jurisdiction over intrastate rail rates will be vested in the ICC. Assuming a state loses jurisdiction, I can only hope that the ICC will act in a more responsible manner in its ratemaking decisions than it has with the certification process.

It is easy to see why the proponents of deregulation have had such great success in passing regulatory reform. One bout with a federal agency will convince anyone that something desperately needs to be done to eliminate the bureaucratic delays faced by the public.

I am again seeking your assistance in dealing with the ICC in this matter. Virginia has procedures in place to administer the Staggers Rail Act. All we request is immediate certification to remove all the questions and uncertainty surrounding intrastate rail rates and practices.

With kindest personal regards, I remain

Sincerely,

PRESTON C. SHANNON.

Senator DANFORTH. Thank you very much, Senator Warner.

Senator WARNER. I would be happy to take questions, but I have to testify on the Tourism Policy Act.

Senator DANFORTH. Does anyone have any questions?

Senator FORD. Yes, John. How are you going to vote on deregulation?

Senator DANFORTH. For the purpose of other witnesses, the early bird rule would have Senator Gorton first, and then Senator Packwood, Senator Ford, Senator Pressler, and Senator Exon, and then myself.

All right. The next witnesses are Chairman Taylor and Commissioner Gradison.

STATEMENT OF HON. REESE H. TAYLOR, CHAIRMAN, INTERSTATE COMMERCE COMMISSION, ACCOMPANIED BY HEATHER J. GRADISON, COMMISSIONER; WILLIAM R. SOUTHARD, DIRECTOR, OFFICE OF TRANSPORTATION ANALYSIS; RONALD S. YOUNG, DIRECTOR, BUREAU OF ACCOUNTS; LOUIS E. GITOMER, DEPUTY DIRECTOR, RAIL SECTION, OFFICE OF PROCEEDINGS; AND JANICE M. ROSENAK, LEGISLATIVE COUNSEL

Mr. TAYLOR. Good morning to you, Mr. Chairman

Mr. Chairman, members of the subcommittee, let me begin by introducing the people at the table with me this morning.

On my immediate right is my colleague, Commissioner Gradison. On her right is OTA Director Southard. On my far left is Bureau of Accounts Director Young. On his right is Rail Section Chief Lou Gitomer, and on my immediate left is the Commission's Legislative Counsel, Jan Rosenak.

I want to thank you for this opportunity to appear here today to present the views of the Commission concerning the implementation and effects of the Staggers Rail Act of 1980. I have submitted a written statement for the record, and I would like to summarize that statement briefly for you at this time.

In our view, the act and its implementation have been generally successful in meeting the congressional goals set forth in the statute. The act was intended primarily to assist the railroads to remain viable and to compete more effectively among themselves and with other modes of transportation, while at the same time protecting captive shippers.

To assist in the revitalization and modernization of the rail system, the Staggers Act encourages competition, provides for the prompt recovery of costs, promotes greater rate and service flexibility without Government interference, and emphasizes the need for adequate rail revenues.

Because of the severity of the recent recession, it is difficult to ascertain definitively the act's impact on the financial condition of the rail industry at this time. Nevertheless, through our experience in implementing the act and the passage of time, we are able to state that the Staggers Act has had a positive effect on the railroad's financial condition.

Earnings of class I line haul railroads for the first 12 months after passage of the Staggers Act, October 1, 1980 through September 30, 1981, increased substantially from the prior 12-month period. In the first year after enactment, operating revenues increased 11.5 percent to $30.7 billion. This was due primarily to greater rate flexibility. In addition, net railway operating income rose 55.3 percent to $1.7 billion from $1.1 billion.

Subsequently, there was a decline in revenues, earnings and volume of traffic during the fourth quarter of 1981. Nevertheless, despite this decline, 1981 industry earnings in terms of net revenues and ordinary income, showed increases over the previous year.

Recent financial results have not been as favorable. The Commission's latest earnings report for the class I railroads shows that revenues, earnings and traffic volume in 1982 declined from 1981 levels. The recession severely affected railroad traffic and earnings during 1982. Considering the magnitude of the recession, however, the industry fared quite well. We believe the effects would have been more severe had the Staggers Act not been enacted.

While the overall rate of return on investment is still far below adequate levels, it has risen well above the level of the mid-1970's. It should continue to improve as the general economy recovers and as a more vigorous and financially viable railroad system emerges.

Another way to judge the impact of the Staggers Act is by how often its provisions are utilized. There has been major activity in a number of areas. For example, as of mid-June 1983, 7,844 rail rate contracts had been filed with the Commission since the effective date of the act. This figure exceeds 8,000 as of July 1, 1983. We now receive about 530 new contract rate filings per month. Contracts have been filed by 115 railroads, including both large class I carriers and small short lines and switching carriers.

Also used extensively are the surcharge and joint rate cancellation provisions of the statute. These provisions have been instrumental in giving carriers expeditious relief from noncompensatory rates and divisions. For fiscal year 1982, we identified 117 surcharges and negative surcharges that became effective. Of these, 93 were commodity oriented and 24 were imposed on light density lines.

As reported to Congress in our joint rate study, it appears that joint rate cancellations are becoming the major tool used by carriers to achieve joint rate relief. Our experience indicates that most parties have been able to adequately adjust to cancellations affecting them. Nevertheless, we are aware of substantial concern expressed over certain cancellations. Partially as a result of this concern and our own interest in monitoring how cancellations have begun altering the joint rate structure, the Commission has directed our Office of Transportation Analysis to undertake a study of the joint rate cancellation issue. This study was also in response to a request made in Ex parte No. 445, Standards for Intermodal Rail Competition. In a petition supported by numerous shippers and several railroads, the National Industrial Traffic League sought the institution of a rulemaking.

In its decision denying the petition, the Commission concluded that a rulemaking would be administratively impractical because the specific facts in each case require individual analysis and adjudication. However, as I mentioned above, we will conduct a study of the changes that are occurring in this area, their reasons and effects, and will determine from the study whether further action is necessary. Comments in conjunction with this study may be requested at a later date.

In my separate expression, I pointed out that Congress intended to balance the Staggers Act goals of competition and adequate revenue levels, that a public proceeding could have explored the Staggers Act goals and the tools available to the Commission to strike that balance, and that such a proceeding would also assist the Commission's adjudication of subsequent proceedings. I further noted that a staff study should supplement, and not substitute for, a thorough examination of the highly important policy issues that were raised by the NIT League.

The Commission has actively employed its rail exemption authority to further reduce unnecessary regulation. The TOFC/COFC exemption has been finalized and affirmed by the court in all significant aspects. We have also exempted agricultural commodities except grain, soybeans, and sunflower seeds. In the finance area, we have granted hundreds of exemptions for individual rail transactions where the transportation or public impact was minimal, or regulation was not needed to protect shippers from an abuse of market power. Other exemptions and further exemptions which are under study are detailed in our more complete statement.

Recently, the Commission has also approved exemptions for export coal and boxcar movements. In Ex parte No. 346 (Sub-No. 7), the Commission found that export coal is sold and transported in a very competitive market where most movements are arranged by a small number of transshipper companies rather than individual mines which can exercise considerable leverage over the railroads. Market competition and natural forces of supply and demand should, the Commission found, establish reasonable and rational rates for this traffic. The decision also pointed out that the Commission retains the power to revoke the exemption should it not live up to expectations. The exemption is scheduled to become effective on September 12, 1983.

In my dissent, I pointed out that world competition is only minimally relevant when there is almost no domestic competition, either intra- or intermodal. As the Commission's goal is to support and encourage competition, and as competition requires relatively equal bargaining positions, to remove all regulation in this instance would also remove what leverage captive shippers now have and lead to what I felt could well be an abuse of market power by the railroads.

In Ex parte No. 346 (Sub-No. 8), the Commission exempted boxcar movements of all commodities except nonferrous recyclables from rate regulation. The exemption was proposed by Conrail and was supported by the Departments of Transportation and Justice, the Federal Trade Commission, and a few shippers. The Commission found that the market share data and revenue/variable cost ratios of record clearly indicated that there is intense competition for boxcar traffic between the railroads and the truckers, and that rate regulation is unnecessary to protect shippers from an abuse of market power.

The Commission stated that the present regulatory scheme for compensation of boxcar use has long since outlived its usefulness. The Commission has therefore adopted a proposal to allow user railroads: (1) to assess charges for empty movements made at the request of the car owner, the AAR or the Commission. These charges may not exceed 35 cents a mile, which approximates the cost of providing the movements; and (2) to store empty cars and reclaim car hire payments at the expiration of a 72-hour grace period after the car is emptied; and (3) to negotiate compensation agreements with the boxcar owners for car hire, empty movements, and storage.

Other aspects of regulation, including mandatory interchange, car supply, car hire and car service where agreements cannot be reached are retained by the Commission. The exemption is scheduled to become effective November 7, 1983.

May I continue, Mr. Chairman?

Senator DANFORTH. Go ahead.

Mr. TAYLOR. I dissented on the ground that the record fails to support this broad exemption. I emphasized the paucity of supporting evidence in the record, the overwhelming opposition to the proposal by the rail industry and virtually all of the parties of record. Regarding the car hire-car service portion of the decision, I expressed concern for the adverse impact that this exemption will have on short line railroads and on future investments in boxcars. Finally, I concluded that this exemption imposed new regulations, in fact, without appropriate notice.

The last significant decision I will mention in this summary is Ex parte No. 347, Coal Rate Guidelines. The Commission has proposed a maximum rail rate policy applicable to captive coal traffic. Under the proposed constrained market pricing approach, rail carriers' pricing of market dominant traffic would be subject to four upward constraints. First, a coal shipper could not be charged more than the stand-alone cost of serving its traffic. Second, captive shippers would not be required to bear the cost of pricing inefficiencies. This constraint also incorporates the statutory standard of honest, economical, and efficient management. Third, the carriers would generally not be permitted to increase their rates on captive traffic by more than 15 percent in a single year after inflation. And fourth, until a rail carrier achieves revenue adequacy, it would be free to adjust its rates on captive coal traffic unless it violates one of the other three constraints.

Comments in the coal guidelines proceeding are due on July 28, 1983.

This was a 3-to-2 decision. Commissioners Sterrett and Andre dissented from the decision that has been proposed in this matter.

Effective competition is the key to the success of the Staggers Act and its implementation. An environment where efficiency, flexibility, and adequate revenues are encouraged will promote such competition and related benefits.

I believe that the Commission is implementing the act with this in mind. Now, Mr. Chairman, I will be happy to respond to any questions that you may have.

Senator DANFORTH. Commissioner Gradison, do you have any statement?

Ms. GRADISON. Just briefly, thank you for the opportunity to appear here today. I support the Commission's testimony. It states that the Staggers Act appears to be working well and does not require revisions at this time. I think the fact that the rail industry has weathered one of the sharpest recessions in our recent history without the heavy losses and without the bankruptcies that occurred during other recent recessions, and that railroads appear to be positioned to make major gains in earnings as the economy recovers, shows that the Staggers Act is working.

The new competitive piggyback services that have been introduced since TOFC and fresh fruits and vegetables have been deregulated provide further evidence of the benefits that the Staggers Act holds in store for shippers and carriers. I expect that many further transportation improvements will emerge and that carriers and shippers, as they gain more experience in working with and negotiating with one another rather than filing tariffs with the ICC and negotiating car hire rates as will be provided through the boxcar exemption, will take advantage of the opportunities for a more efficient transportation system.

I am sure that Chairman Taylor and the other ICC staff members who are here today can answer any technical questions that you have, and I am happy to address them as well.

Senator DANFORTH. Thank you very much.

Senator Gorton.

Senator GORTON. Chairman Taylor, can you give us any indication as to when the Commission will act on pending petitions for reconsideration and stay of the May 2, 1983, boxcar order?

Mr. TAYLOR. Senator, we have probably received more furor over that boxcar decision than any other decision the Commission has ever entered. The simple answer to your question is that we have got all kinds of petitions for reconsideration. Let me show you, for example, a sheet of all of the Members of Congress. We have received no less than 129 very irate responses from the Members of the House of Representatives. It is a totally nonpartisan proposition, in that we have heard from 69 Democrats and 60 Republicans.

In the Senate, we have heard from 66 Senators, which is two-thirds of this body. Again, it is quite nonpartisan, 30 Democrats and 36 Republicans. As a matter of fact, insofar as the members of this committee are concerned, of the 17 members, we have had rather irate letters from 14 of the 17 with respect to this particular matter. That is of considerable importance to me.

We got one letter from Congress that had 60 Congressmen on it. We have another letter from the Senate that has 15 Senators on it.

I have got literally pages here of requests for reconsideration which I would be glad to submit for the record if you would so desire. Because of the fact that two of the Commissioners who are no longer sitting, Commissioners Gilliam and Simmons, who I know are strongly opposed to the boxcar exemption, but who participated in the oral argument before, and another Commissioner, who is presently sitting, and who supported the boxcar exemption, but who was on vacation the last time the oral argument was heard, what I propose to do is to carefully consider all of these petitions for reconsideration, and then I would submit that we could have some oral arguments, some further discussion and explanation of exactly what has gone on. I think that with all of the people who have expressed themselves as loudly as they have—I cannot tell you how many letters we have had from the short lines—I even got one at home on Saturday from a short line railroad down in South Carolina—that I think we have got to give it serious attention. I would hope that as soon as Congress is back in session after the August recess, so that those who have indicated such a strong interest will have an opportunity, to the extent they want to, to come down, that we would have some kind of oral argument. The decision becomes effective November 7, and I would hope that we would be able to do something prior to that time. If we are unable to do so, perhaps we can come up with a stay.

Ms. **Gradison**. Senator, the petition for stay has not been circulated for consideration by the Commission. However, Vice Chairman Sterrett, Commissioner Andre, and myself, a majority of the Commission, are willing to extend the effective date of the decision by 60 days. This would give us an opportunity to more fully consider the current petition for reconsideration. We are not at this time willing to reopen the decision, nor are we willing to stay the decision, as we feel it is premature, as the Chairman stated. It is not scheduled to become effective until November 7. We are willing to extend it by 60 days, and yesterday we did make a request to the Chairman's office to do just that.

Mr. **Taylor**. I see no point, Senator—I think that is backwards—to talk about a stay now. We really have 3½ months until the decision becomes effective. I think we should afford the parties who are so interested in this whole matter a full opportunity to come down to the Commission and express themselves. If we cannot dispose of it by the deadline date, then it seems to me a stay can be entertained at that time, and we would certainly do so. I would not think it would have to be any longer than 60 days.

Senator **Gorton**. Thank you, Mr. Chairman.

You have indicated the depth of feeling in Congress over this issue. I hope that that depth has communicated itself to Mrs. Gradison and the people who put this order into effect, that there is likely to be a highly negative reaction if something is not done about that order.

I would like to go on with you, Mr. Chairman, and ask you what options you believe to be open to the Commission in this question, and specifically what the best course of action is to avoid grave economic injustice to class III railroads, their shippers, and boxcar owners.

Mr. **Taylor**. Well, that is really a very difficult question, Senator, for me to answer. Because, if we are going to take the matter and have another look at it, and if we are going to go through some further oral argument, as I would certainly hope we do, in order to carefully consider all of the material that has been submitted to us, to tell you at this time specifically what we might do or not do with respect to it, I think, is really a prejudgment of the matter.

I am not trying to cop out here on a pending matter proposition with you, but I think you are aware of the extensive numbers of problems, particularly in the car hire, car service portions, and the impact on the class III railroads. It is enormous. There is no question about that. I discussed a good part of that in my dissent, so I think you know what my views are, and what my concerns with the problems are. But to specifically sit here and talk about what we might do or what we might change or how we might do it, I think, really would constitute prejudgment, and I really don't think I should do that.

Senator **Gorton**. Thank you. I will return for a second round later.

Senator **Danforth**. Senator Packwood.

The **Chairman**. Mr. Chairman, are the complaints you are getting in terms of substance evenly spread across the board, or are many more of the complaints about boxcar rental and from the class III railroads than they are from the shippers?

Mr. **Taylor**. Well, we have gotten them from both. There are very, very few shippers who supported the proposition in the first place, Senator Packwood, and most of those were not ones who really used boxcars. I think probably you would have to say that the big, big portion of the complaints and static has come from the class III railroads. They feel that they are the ones who are going to suffer most severely, particularly with the car hire, car service portions, which amount to reregulation in that area. They are very, very concerned that some of them are going to be put out of business. There is one short line railroad which sent a petition to the House and indicated that had that rule been in effect for the last couple of years, it would have cost him some $9 million. They feel it would far exceed any revenues they might receive. So that is really a very important matter of concern to them. I think that is where most of them have come from.

The **Chairman**. I want to assure Commissioner Gradison that there are those on the committee who take the majority opinion very satisfactorily. I liked the opinion. The complaints I have had—and we have all had them—have come mostly from boxcar owners or the class III railroads. The shippers, or at least from the contacts I have had, the bulk of them, have said they can live with this decision and they like it.

Ms. **Gradison**. Thank you, Senator. If I could explain just briefly, why we think that this is not unfair to short line carriers. We do not think it is unfair to any railroad, large or small, to require it to bear the cost which its decisions impose on other railroads. It is not a little guy versus big guy situation. Before the Commission's decision, railroads or shippers had the incentive to purchase rail cars solely to earn per diem charges that would accrue while the cars were on the tracks of another railroad.

They have this incentive even if the long haul railroad had a surplus of its own equipment, and would have to incur considerable expense to return foreign cars empty to the shipper or the railroad. In other words, these railroads or shippers were not earning their keep by engaging in transportation, transportation to the junction with the line haul carrier. Instead, they went into the car ownership business and attempted to make money by earning per diem on empty movements.

Shippers or short line railroads which do not own cars will not be faced with this problem.

The **Chairman**. You can tell that from the complaints we get. From those railroads that do not own the cars, there is no great complaint. Let me switch, Mr. Chairman, to a question about your coal rate guidlines. How are your guidelines going to work to constrain rates? The railroads say they would not even go up 15 percent, as permitted by the guidelines. Explain to me how you think, if they are not going to go up that far, your guidelines will work to constrain the coal rates.

Mr. **Taylor**. Well, I think, Senator, I should explain at the outset—and by the way, this is a decision which Commissioner Gradison and I agreed upon. We no longer have a majority on it. We had two dissenters in this matter, Commissioners Sterrett and Andre, who felt that the proposal was too restrictive. But I think it is very important to consider at the outset that these four constraints are intended to function as a matrix. I think one of the things that has happened is that people have reached into the basket and they have plucked out the 15 percent and held it up and said, well, you are going to automatically assure every railroad the opportunity to raise rates by 15 percent.

Or they have looked just at stand alone costs. I think you have to look at all of them together. In most instances, stand alone costs will be a very considerable constraint, particularly if you have a grouping of shippers. If you do not, and you have a shipper standing alone, then the 15 percent is intended to come into play, and the management efficiency factors of Long-Cannon are intended to be considered, and the thought is that all of them will be looked at together. The railroads have said they are not going to go up 15 percent. To me, that means that has been a meaningful constraint already, that they are not going to go up that much, and I am quite pleased that that is the way that has worked out. I think if you look at all of them together, then it is a much more meaningful process, rather than plucking one of them out and just holding it up. Unfortunately, that is what has been done. Now, this proceeding, too, is still pending. The comments are due by the end of this week, as a matter of fact. We have received a number of them already, and I am sure we are going to probably receive some more.

I have asked the Bureau of Accounts to assemble them for the Commission's benefit, categorize them as to who feels what about what we proposed, and we intend to analyze them very, very carefully before we come up with a final rulemaking in this area. You know, we tried four times and nothing has worked, but I think these rules have a real chance of being successful and achieving what was really intended by the Staggers Act—to provide this important balance, particularly in a coal area where you have captive shippers, between that problem and allowing the railroads to become revenue adequate with one of the most important commodities that they ship or handle.

Senator **Danforth**. Senator Exon.

Senator **Exon**. Thank you, Mr. Chairman.

Mr. Taylor, let me ask you what is your opinion or your bias or lack thereof, with regard to regulation and deregulation? Let me put the question this way: Aside from the Staggers Act, could you enlighten us as to what your basic feeling is on railroad deregulation? Would you feel possibly that we should have total deregulation, no control by the ICC? How far do you think we should go in this area? What is your philosophy?

Mr. **Taylor**. Philosophically, Senator, I am a deregulator. I think that that is the direction in which we are going, and I think that is the direction that we should be going. I do not think there is any question about that. But I am also one who has believed quite strenuously, and said so on a number of occasions, that we should do it with a degree of caution and care. We should particurly do it with some caution and care in order to see that in the process of deregulating we do not wind up issuing an engraved invitation for reregulation.

Now, particularly in the rail area, I think the important consideration is the extent to which there is some competition, either intramodal or intermodal, and of course, as you know, the Commission also looks at geographic and product competition. That is the subject of some litigation in court, and we should have a ruling soon as to whether or not those are valid competitive considerations for the Commission to undertake. But my basic view is that competition is always going to be a better regulator than the most brilliant bureaucrat Congress or the White House can find. There just is not any question about that.

And when you have got competition, it ought to be allowed to do its thing. The problem in the rail area is, as we all know, and that involves grain in your State and coal in some other areas, that we have some captive shippers. The railroads do not like to call them captive shippers, but let us say it is a market dominant situation. We really do not have the free play of competition. And to the extent that you thoroughly and quickly and just without any care and with some reckless abandon remove regulation, then it seems to me what you really are doing is issuing an invitation for reregulation which may be even more oppressive and getting back into some of those areas where there is some competition.

And I think that is the constant danger, as you move down the deregulatory path. We should do it with the caution and care and concern that will not lead to a whole lot of demands for reregulation. Every time the Commission does something which some people consider to be irresponsible, we get a backlash up on the Hill. We have seen it. There is a Jeffords bill now because of the boxcar decision. There are a couple of Ford bills and a Rahall bill as a result of the export coal decision and the maximum coal rate guidelines.

I do not think the maximum coal rate guidelines are any difficulty as proposed, although it is not a final proceeding yet. We still have to look at it.

I guess the bottom line is, I am a deregulator. I think we ought to do it with care, and we have to be terribly concerned about those areas where there really is not any competition.

Senator EXON. So really what you are saying, if I can summarize and put it in words that I can understand, you are a deregulator, but you think we need indeed to have some of the provisions approved by Congress in the Staggers Act that take at least significant steps in the right direction as far as fairness is concerned, and you think it is wise that the ICC have some authority in that area.

Mr. TAYLOR. I certainly do, and I am one who has tried very, very hard in the 2 years that I have been at the Commission to follow the law whenever and however I can, because to me that is terribly important. I think if we want to come up and suggest further changes to Congress in the deregulation area, that is fine. But as long as we are down there with the law as it now stands, our responsibility under our oath is to implement the law as it is written, and not to try to emasculate it or discard it or get around it.

Senator EXON. Your warnings are well taken. What the Congress has given, the Congress can taketh away.

Mr. TAYLOR. Correct.

Senator EXON. I think that is something that all should bear in mind. I think probably one of the concerns that many of us have with regard to the implementation of the Staggers Act, particularly with regard to the captive shippers, is the standards by which you and the Commission are acting.

Let me ask you this question. Under your present standard, all class I rail carriers are revenue inadequate, yet we continually read in the press about the strong financial position of numerous railroads. Indeed, several railroads have been referred to as cash cows. Earlier this year, the Burlington Northern, the railroad which under the ICC standards is severely revenue inadequate, tendered $600 million to buy El Paso Natural Gas. At this time, CSX, another purportedly revenue inadequate carrier group, is proposing to purchase the Texas Gas Resources Co. for $1.8 billion.

How can the ICC rationally find that a carrier such as BN and CSX are revenue inadequate when they have huge cash reserves that they are using to diversify their operations? Is that not inconsistent?

Mr. **Taylor**. Well, I think the important thing to remember in both of those cases, Senator, is that the acquiring entity is a railroad holding company. The Burlington Northern Holding Co. is into an awful lot of things besides just running a railroad, and some of those endeavors are quite profitable. It is holding company funds and resources that they intend to use to make that acquisition.

Essentially, the same is true insofar as the CSX operation is concerned. It is the CSX holding company that is involved. That may well turn out to be an exchange of stock, too, by the way, as opposed to the railroad entity making that acquisition.

Senator **Exon**. You do not think these railroads are shifting those profits back and forth?

Mr. **Taylor**. We do the best we can to monitor them, and I would be glad to have our Bureau of Accounts Director, Ron Young, discuss that with you for a moment if you would like.

Senator **Exon**. Mr. Chairman, my time is up. It is up to the chairman. This is something that I will get into later, if not now, because I really believe that many of us are very much concerned about the narrow focus that the ICC is taking with regard to revenue-inadequate status, and that may be one of the reasons that we think the protection that we wrote into the Staggers Act is not being properly implemented by the ICC as we intended.

Mr. **Taylor**. We have a proceeding on revenue adequacy now, Ex parte No. 393 (Sub-No. 1). The comments are due in on that one, I think, by September 16. Once again, Commissioner Gradison and I agreed on that proposition. Commissioners Sterrett and Andre both dissented. We have some comments which will be coming in, and we will be looking carefully at them. One of the things we are going to try to do is inject some inflation adjusted accounting into that proposition. Revenue adequacy is very, very important. That is one of the congressional standards, and we want it to be as accurate as we know how to make it.

Senator **Exon**. Thank you.

Senator **Danforth**. Mr. Chairman, in defining what is and what is not effective competition, the ICC is using four standards. Two of those standards are comprehensible to me. One is intramodal competition and the other is intermodal competition. From the standpoint of the commodity to be shipped, these standards take into account whether there is an alternative mode of competition which would contain the price of shipping that commodity.

However, the ICC is using two other guidelines to determine effective competition. One is geographic competition, that is, can the utility purchase coal from some other region? Second, can it use another product? It is not readily apparent to me why the availability of coal from some other source is significant, nor is it understandable to me why the availability of some other product might be relevant.

It would seem, just at first blush, that the relevant question is whether or not there is an alternative mode of transportation for this shipment of a particular commodity from a particular place to another place.

Can you describe the Commission's reasoning?

Mr. TAYLOR. Let me just talk generally about geographic and product competition, and then we will talk about it insofar as coal is concerned. Since 1979, the Commission has stated that evidence of geographic and product competition is admissible and relevant. If the evidence of geographic and product competition which must be brought forth by the rail carrier is inconclusive, then such evidence is given minimal weight.

Now, in a 2-to-1 decision last December, the U.S. Court of Appeals for the Fifth Circuit held that the Commission's regulations for determining market dominance, which is the threshold question of whether the Commission gets into the act, and these are the four tests to determine in our view whether or not market dominance exists, were invalid because the statutory definition of market dominance in 49 U.S.C. 10709 does not permit consideration of geographic and product competition. However, on March 7, petitions for rehearing en banc were granted by the court. Oral arguments were held on June 7, and we are still awaiting a decision.

So whether or not we will be able to use them remains to be seen. Now, as to coal, I discussed this at some length in my export coal dissent. You have adequately, I think, described what is involved. The geographic competition is the question of whether or not somebody who wants to buy that coal can take advantage of competition, let us say, between Appalachian and Western coal reserves. I felt very strongly in my dissenting opinion in the export coal decision that there is no such competition, that there is no such interchangeability, and I went to some length to try to point out why.

As for product competition, you have adequately described that, too. Is there some other substitute commodity or product that can be used? And I think coal is used for the purposes that are involved, and I saw no product or geographic competition involved insofar as coal is concerned.

Now, Commissioner Gradison may want to expand upon that from her point of view, but those are my feelings.

Senator DANFORTH. Well, I am more interested in the concept than in the facts with respect to coal. It just does not strike me as being a reasonable determinant of competition.

Mr. TAYLOR. I agree with you, but I think Commissioner Gradison may not, so perhaps she would like to respond.

Ms. **Gradison**. Senator, the concept of product and geographic competition deals with substitution of a different product or the same product from a different location. If the choice is there to use natural gas or oil as opposed to coal, that is product substitution. Geographic competition obviously involves the source of the coal. A specific example of geographic competition with regard to coal took place this past winter when Conrail was able to offer contracts on coal from more local sources to carry the coal into the Northeast—coal which formerly had come from West Virginia. Ultimately, I believe that the Norfolk Southern made arrangements and contracted to get the traffic back. This was an example of geographic competition. In other words, there was a separate source of coal available. The shipper was able to use a different carrier, and that was geographic competition. Product competition again is the substitution of a different product.

Senator **Danforth**. You have defined the definition. I mean, you have described the meaning of it. I just do not get the principle of it.

Ms. **Gradison**. Well, the principle is that these concepts serve as a source of competition. If a utility does not like the prices that it is offered from a particular source, by that single source railroad serving it, that utility has the option of pursuing product or geographic options that are available, pursuing them, and creating those options.

Senator **Danforth**. That is kind of like saying to the beef producer, well, if chicken is available at a better price a person does not have to eat beef.

Ms. **Gradison**. We think it is a reasonable consideration, and we do not use it as the sole consideration, but it is certainly one that we think is usable. The courts may differ with us, and as the chairman said, we will find out. But to date, we have been attempting to use it.

Senator **Danforth**. Senator Kasten.

Senator **Kasten**. Thank you, Mr. Chairman.

The Green Bay Packaging Co. in Green Bay, Wis., submitted comments in the Ex parte 346 related to the impact of the boxcar decision on its operations, and more specifically on its wholly owned short line railroad. Mr. Chairman, I would ask that a copy of that statement be included in the hearing record.

[The following information was subsequently received for the record:]

[Before the Interstate Commerce Commission, Washington, D.C.]

Exemption From Regulation Boxcar Traffic—Ex Parte No. 346 (Sub. No. 8)

REPLY OF GREEN BAY PACKAGING CORPORATION, ARKANSAS KRAFT CORPORATION, AND LITTLE ROCK & WESTERN RAILWAY CORPORATION TO THE PETITION FOR RECONSIDERATION OF BRAE CORP.

Green Bay Packaging Corporation (GBP) hereby replies on its own behalf and on behalf of its wholly owned subsidiary, Arkansas Kraft Corporation (AKC), and its wholly owned subsidiary, Little Rock & Western Railway Corp. (LRW), in support of the Petition for Reconsideration filed on May 20, 1983 by BRAE Corporation in the above-captioned proceeding. GBP respectfully requests that the Commission reconsider its final decision for the reasons asserted in the BRAE Petition. GBP believes that the Commission's decision fails to recognize that the new car hire rules will expose shippers to abuses of market power by Class I carriers. Moreover, the Commission incorrectly assumes that all shortlines are mere conduits for tax shelters; in fact, the overwhelming majority of shortline railroads, like LR&W, provide essential services to the shippers on their line and derive a large majority of their revenue from such service. In this reply brief, GBP seeks to provide the Commission with specific factual information about its shipping operations and the impact of the Commission's decision on GBP and LR&W.

I. Current Operations

GBP formed the Little Rock & Western Railway Corporation on June 1, 1980 to operate 44 miles of track between Little Rock and Perry, Arkansas. LR&W exists as wholly owned subsidiary of AKC, LR&W's major shipper, which is in turn wholly owned by GBP. The trackage was formerly owned by the Rock Island Railroad Company and was abandoned when the Rock Island entered bankruptcy. The LR&W takeover was premised upon the continuing need of the shippers on the line to have access to the national rail system.

LR&W's service is specially designed to meet the needs of its major shipper, AKC. AKC ships primarily paperboard products and liner board in the fleet of 350 50-foot boxcars leased by LR&W.[1] These baxcar shipments are threatened by the Commission's rulemaking.

GBP sought a stable supply of *clean, well-maintained* boxcars to satisfy the needs of AKC and realized that it could not count on the Class I railroads to provide such cars on a consistent basis. GBP obtained a stable supply of clean boxcars and no maintenance responsibilities through a leasing arrangement which allows LR&W to share in the revenue from the railcar movement. As a result, LR&W leases all of its boxcars pursuant to long-term leases. The shipper is now better served by a railroad entirely responsive to its needs and which provides a supply of clean boxcars for its shipments.

II. Impact of the Commission's Order on Shippers and Shortlines

The Commission's decision acknowledges that the shortline railroads may suffer as a consequence of the boxcar order;[2] the Commission, however, chooses to dismiss this harm by implicitly characterizing all Class III railroads as tax shelter schemes which send boxcars offline solely to earn per diem fees. See Commission Order at p. 26. The LR&W does not in any way fit the description of a tax shelter railroad. Boxcars are sent offline to serve the needs of the shipper. Because the shipper's needs are constant, LR&W requests that the boxcars be returned to be reloaded and shipped out again.

The Commission's establishment of reclaim and empty return charges will severely impact GBP and AKC as well as LR&W's profitability and service capabilities. The impact can best be described by examining a typical shipment under the current system and comparing those revenues with the revenues anticipated and allowed under the Commission Order:

"A typical shipment from Perry, Arkansas to Green Bay, Wisconsin takes approximately 20 days and covers 1,672 miles round trip. LR&W currently earns $6 per car per day for the use of its car offline. (The remainder of the per diem charge is paid to BRAE Corporation). For a 20 day trip, LR&W therefore earns $120.

"Under the Commission Order, LR&W will only earn the $6 per day hire on the 10 day trek to Green Bay (add $60). These earnings however will be reduced by the 35¢ per mile charge for the 836 mile empty return from Green Bay (subtract $293), LR&W will therefore lose $233 on car hire for the one trip."

The difference between the current system and the Commission ordered regime is $353 per car each trip. When this figure is compounded over a period of a year for all of LR&W's boxcars, the impact upon LR&W's profitability is staggering.

LR&W currently earns approximately $480,000 per year in car hire. This represents 42 percent of LR&W's current annual profitability. Extrapolating from the example described above, LR&W will lose $932,000 in net car hire after the Commission's Order [3]—an expense which will eliminate LR&W's profitability and generate a net loss of more than one-quarter of a million dollars ($1,140,000 – $480,000 – $932,000 = ($272,000).

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[1] LR&W also maintains a reserve pool of an additional 50 boxcars to service AKC's peak needs.

[2] The Commission states:

"We agree that small entities could possibly experience adverse effects * * *" [p. 29]

"Shortline railroads, on the other hand, may have good cause to be concerned about the near term effects of the proposal." [p. 26]

Although the Commission asserts that the empty return charges can be offset by charges LR&W can claim on foreign cars on its line, this simply is not true and never will be true for shortlines such as LR&W. The only foreign boxcars that may appear on LR&W's lines are the occasional inbound boxcars hauling wastepaper for AKE's papermill. These boxcars are old, not very clean and are not practical for outbound shipments. But returning these cars empty generates only a token charge of 35¢ a mile for the 44 mile track for a total of $15.40. LR&W would have to return 60,520 empty cars (166 cars per day) the full length of its track to offset the empty return charge that it will incur.

The Commission erroneously believes that the loss the shortlines incur on the empty return charges can be recouped when demand for boxcars improves and the shortlines are able to negotiate higher car hire rates. However, demand for LR&W's boxcars has remained fairly constant, because LR&W serves only the constant needs of its shippers. Furthermore, the disparity between empty return mileage incurred and collected will always exist regardless of demand, because of the relatively small length of LR&W's track with respect to the distance of the LR&W boxcar shipments.

The damage inflicted by the Commission's order is not limited to the shortline railroad. The shipper will face increased shipping costs to cover empty return charges and the loss of a reliable source of clean, well-maintained boxcars. The railroad industry as a whole may suffer by increased shipper reliance upon truck hauling to replace the impaired rail service. Furthermore, the shipper, AKC, will be negatively impacted as owner of the shortline. The Commission has completely ignored the substantial number of shortlines that are owned by shippers as pointed out in the BRAE Petition for Reconsideration.

The Commission claims that the new regulatory framework will make the national rail system more efficient, foster sound economic conditions in transportation, promote reasonable rates, and promote energy conservation. Commission Order at p. 28. GBP does not agree and requests the Commission to reveal whatever evidence it has to support these conclusions.

The most elementary logic points out the fallacy of the Commission's unsupported claims of increased efficiency. Under the current system, each railroad is encouraged to move LR&W's cars as quickly and efficiently as possible to avoid accumulating unnecessary car hire charges. The Commission's Order, on the other hand, allows a railroad to offset car hire with a reclaim charge and fails to prevent circuitous empty return routes to collect a higher mileage charge. There will be no per diem charge as an incentive for the railroads to act expeditiously or efficiently on an empty return.

Throughout the rulemaking, the Commission has attempted to avoid the argument that many small businesses relied upon Congressional and Commission inducements to purchase or lease boxcars. The Commission has asserted instead that boxcars were purchased mainly in response to the Commission's incentive per diem charge of the late 1970's. Because the incentive per diem was always known to be a temporary measure, any reliance upon its performance is deemed to be improper by the Commission. LR&W, however, was not formed until after the incentive per diem charge was removed and obviously could not have relied upon that particular incentive. LR&W, in its negotiations with its shippers, boxcar lessor and Class I railroads acted in a sound business manner in reliance upon the Congressional requirement of fair car hire compensation, an inducement which was again confirmed and preserved by the Staggers Rail Act of 1980. LR&W reliance upon the statutory requirement of fair car hire compensation is reasonable, justified, and should not be arbitrarily abused.

III. Conclusion

The relief requested by BRAE is necessary to meet ICC statutory requirements for: (1) fair car hire compensation; (2) protecting shippers from an abuse of market power, and (3) protecting small business entities in the railroad industry. For all of the above reasons, GBP, AKC, LR&W urge the Commission to reconsider the Commission's Order in Ex Parte 346 (Sub. No. 8) and grant the relief requested by BRAE Corporation.

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[3] If LR&W currently earns a net of $480,000 on car hire based upon expected revenue $120 per round trip, and it is known that that same typical trip will cost $290 under the Commission's new regulations, LR&W's total car hire gain or loss can be extrapolated two different ways:

Method 1: $480,000/$120 = 4,000 boxcar trips per year. 4,000 boxcar trips times a loss of $233 per trip = $932,000 loss.

Method 2: $120/$480,000 = – $233/ x; x = – $932,000

Either method shows a loss of $932,000.

Senator **Kasten**. In that statement, the Green Bay Packaging Co. compares the revenues from a typical shipment under the current system with the anticipated revenues under the new car hire rules, and frankly, the result is devastating.

The difference between the current system and the Commission order is $353 per car per trip. Over a period of a year, we are talking about a loss of $932,000 in net car hire payments, and as a result the Green Pay Packaging Co. short line will lose more than one-quarter of $1 million.

This is an example where we have a shipper who also has an interest, a financial interest in a short line. So I believe it is important that we reconsider this decision. I do not want to open up the questions that the Commissioner has responded to with Senator Gorton and others, but I think it is very, very important.

And I am told also that the Department of Transportation is asking for at least part of the decision—they say the Commission itself acknowledges at page 26 of its decision that short line railroads, on the other hand, may have good cause to be concerned about the near-term effects of the proposal.

So I think it is important. And Mr. Chairman, I would ask unanimous consent that this letter also be included as part of the record.

[The following information was subsequently received for the record:]

U.S. Department of Transportation,
Washington D.C., June 20, 1983.

Ms. Agatha L. Mergenovich,
Secretary,
Interstate Commerce Commission,
Washington D.C.

Dear Ms. Mergenovich: The Department of Transportation (DOT) is today filing a formal reply to the petitions for reconsideration of Sea-Land Service and Totem Ocean Trailer Express. The purpose of this letter is to address certain other issues raised for reconsideration, particulary those relating to boxcars which are used regularly or exclusively by a single shipper.

DOT is in fundamental agreement with the May 2, 1983 decision of the Commission. The decision advances needed deregulation, the benefits of which are outlined by the Commission at page 20 of its decision. In addition, the Commission has, we believe, properly dealt with the problem of empty, and therefore non-productive, movement of freight cars around the country.

Notwithstanding DOT's approval of, and agreement with, the Commission's decision, we do suggest that the Commission consider the advisability of a separate proceeding to deal with boxcars owned or leased by Class III railroads which are used regularly or exclusively by one shipper. This issues, which has been raised most forceably in the Petition for Reconsideration of Brae Corporation, applies to a relatively limited number of cars (Brae asserts the total is 11.6% of the present national pool). Separate treatment for these cars has, nevertheless, received considerable support, particularly from Class III railroads. The Commission itself acknowledges at page 26 of its decision that "Short line railroads, on the other hand, may have good cause to be concerned about the near term effects of the proposal."

Because DOT is not convinced that the evidence now before the Commission is sufficient to fully evaluate the exemption sought by Brae, we urge the Commission to consider a separate proceeding to deal with those boxcars owned or leased Class III railroad and in regular or exclusive use by one shipper.

Our second suggestion relates to the empty car return problem. It is apparent to us, and we believe to the Commission also, that simple boxcar rate exemption would have little effect unless accompanied by a solution to the empty car return problem.

In that regard, we suggest that the Commission's ruling be more specific than as set forth in its May 2 decision. For example, we believe that the Commission should state rules that will apply in the absence of bilateral care hire agreements. These rules would address such issues as (1) the maximum appropriate daily storage charge, (2) when the storage charge would end in the event that a request for the return of an empty car is received, (3) how, ultimately, must a car be returned (since the railroad holding the car is no longer paying per diem charges, there might be little incentive to return the car promptly even if no net storage charge is being levied), (4) whether per diem shall be paid during the car's return trip to its owner, and (5) under what circumstances would an owner be responsible for the car return charge of 35 cents per mile when the movement is directed by another party, such as the Commission.

Sincerely,

ROSALIND A. KNAPP,
Deputy General Counsel.

Senator **KASTEN**. Now, section 10505 of the Staggers Act authorizes the Commission to exempt aspects of rail transportation from regulation. I do not question that removing burdensome regulations is a laudable goal and I appreciated Chairman Taylor's comments about deregulation.

Commissioner Gradison, on what statutory authority did the Commission base its decision in ex parte 346, and specifically, do you classify the new 35 cent per mile empty movement charge and the storage-reclaim charge as an exemption from regulation? It seems to me that what you are doing, at least in those two instances, is reregulating rather than deregulating.

Ms. **GRADISON**. I will first attempt to explain the first part, which is, we used—we exempted the boxcars under sections 10505(a)(1) and (a)(2)(B), (a)(1) being that it is not necessary to carry out the national transportation policy, and (a)(2)(B) being that it is not needed to protect shippers from abuse of market power.

We did not use the limited in scope portions of (a)(2)(A).

Senator **KASTEN**. Do you classify the 35-cent per mile empty movement charge and also the storage-reclaim charge as an exemption from regulation? Clearly, that is reregulation, is it not?

Ms. **GRADISON**. I had not considered it that way. We made the change in an effort to provide an opportunity for reduction in empty car movement. The cause for the entire decision is the excess capacity of boxcars at the present time. If no more boxcars were built, we would have more than enough boxcars to do until the year 1990.

The storage-reclaim charge is an effort to reduce the movement of empty boxcar equipment throughout the country, and this was a suggestion within the proposal and we accept that suggestion.

If it were my choice, I would just have completely deregulated the whole thing, because I feel that—and I am speaking for myself at this moment; I am not speaking for the majority. I feel that this is an opportunity for the carriers to negotiate a portion of the rail transportation service that has not been a part of the free market in the past.

It has been a prearranged, fixed price. In order for the cost for use of boxcars to be reduced, the equipment charge has to be factored into that. And that is what this portion of the decision attempted to deal with.

Senator **KASTEN**. With two new regulations or two new charges.

Ms. **GRADISON**. We did not consider them charges.

Senator **KASTEN**. Or regulations?

Ms. **GRADISON**. Opportunities.

Senator, we did not consider them as regulations. We did consider them as factors in the decision.

Senator **Kasten**. But you can see how somebody that does not know a whole lot about this business might be able to consider them as charges or regulations?

Ms. **Gradison**. Yes, sir, I do. But I am going to have to refer to the decision itself, because it explains it more completely than I can.

Senator **Kasten**. Mr. Chairman, my time is up.

Senator **Danforth**. Senator Long.

Senator **Long**. Mr. Chairman and members of the Commission, in ex parte 347 you said: "We believe that maximum rates on market dominant traffic in general should be permitted to increase to the extent necessary for a carrier to achieve revenue adequacy." Does this mean that if it is necessary for a captive shipper's rate to double, triple, quadruple, or even go up by 100 to 1 above inflation, this would be acceptable to you if that is what it took to enable that particular railroad to achieve revenue adequacy?

Mr. **Taylor**. Well, again, Senator, I think you have to, as I tried to explain, look at the maximum coal rate guidelines on the basis of a matrix of four constraints. What we were really trying to do was to provide as much free market here as we could, but at the same time to protect captive shippers.

And as you well know, many, many coal shippers are, in fact, captive. So in putting these guidelines together—and I think I can speak for the Commissioners on this. Certainly Commissioner Gradison and I agreed on this approach. We felt that if you look at all four of those constraints together—and we tried to build some of your Long-Cannon considerations into the management efficiency aspect of it, too—that it would be a meaningful approach.

Now, as I say, at the end of this month, in fact the end of this week, the comments are due and, to the extent that they indicate that once again we are off base, we will have to have a further look at it. If you would like to get into some of the details—I think probably our Bureau of Accounts Director Young has had more to do with putting this whole proposition together. And I think, Mr. Chairman, if you would indulge us in just a couple of minutes from him, maybe he can give you some nuts and bolts that would be helpful.

Senator **Danforth**. This is Senator Long's 5 minutes.

Senator **Long**. Could I just for a moment talk about the 15 percent. I know it is a long time for a younger person, but I have been in the Senate now for 35 years, so that does not seem very long to me.

Over a 36-year period, 15 percent a year over and above inflation would mean an increase of 256 to 1, according to my calculations. You might work it out differently, but does that not seem a little bit excessive? Do you think it really takes that much against a captive customer, 256 to 1, to make him whole? That is kind of hard to justify. For every $1 I am paying now, I am going to be paying $256.

Mr. **Taylor**. I cannot argue with your mathematics, Senator. But the point is that the 15 percent is to be looked at in view of everything else. And when a railroad reaches revenue adequacy—and I think Mr. Young can explain that, with our constrained market pricing approach—we feel a good number of the coal carriers will reach that revenue adequacy long, long before the period of time that you have described, more like 6 or 7 years.

And that also is one of the constraints. There are a couple of the other Commissioners who did not agree with that as a constraint, but that is one of the four that we have imposed.

Ms. **Gradison**. The 15 percent should not be considered by itself.

Senator **Long**. I am also looking at what you people seem to be talking about in terms of revenue adequacy. For example, when I first raised this issue some years ago and offered an amendment that you are familiar with—at least some of you are familiar with, and I know Ms. Rosenak is very familiar with it—my whole thought was that this deregulation sounded great at the beginning, but given some time it could work out to a real rape of the public interest in ways that would require us to legislate to put the genie back inside the bottle in some fashion, and to anticipate some of that.

So I offered an amendment, which was strongly supported by the electric power generating companies. They are regulated utilities themselves, so goodness knows they ought to be sympathetic to somebody who is regulated. When they have to go before a commission to justify their rates, they have to talk about their rate base, they have to talk about their cost of interest on their money, they have got to talk about whether they are operating efficiently. And they have got the burden of proving that they are doing a good job to get the money that they are asking for, to get those rates.

So the utilities look at this double standard. They say, here is what we have to do to get these rate increases, and we find ourselves captive to the railroads. We do not think those State commissions are going to let us get away with what these railroads are getting away with, and we do not think it would be right if they did. Then they find that they cannot even get the information the carriers have in their books. Are you aware of that now, Mr. Chairman?

Mr. **Taylor**. Well, I know there has been a discovery problem, which we are trying to address, and I feel it is very important to have adequate discovery. I think you and I have discussed that subject previously.

Senator **Long**. It makes me think about a law we had back in the olden days in Louisiana, and I did not make it that way, that is how I found it. But if you were trying to allege that someone had stolen the election from you, you had to allege how many votes he stole and from what box.

Lacking that information, you are out of court. And that law was not adequate for somebody who was thinking he was not getting a fair count.

And it seems to me that, at a minimum, somebody who wanted to challenge that rate should be able to have the information that those railroads have. Here is somebody who is providing electricity to a million people out there, and he is a captive. He is at the mercy of these people, unless Congress, or you, or somebody does something to protect the consumer out there.

I do not believe that the golden days of railroading mean that we have got to return to the days of the robber barons. I do not think that you do, knowing you, Mr. Taylor.

Mr. **Taylor**. I strongly agree with that.

We should not be returning to the days of the robber barons.

Senator **Long**. Frankly, having sponsored that amendment, I know that you look at that and you wonder, well, gee, what burden does this impose? Well, it seems to me that in that amendment that I sponsored—and Senator Cannon joined me in it when we agreed to it in the Senate—we put in the language that you can protect the public interest if you want to.

Now, it is one thing to talk about competition, something else to talk about the raping the public is going to take when there is no competition. And to some people this concept of maximizing their profit is what free enterprise is all about.

Now, what is your position on that? How are you going to fix it so that people trying to look after the public interest can prove their case when the facts are there? Or are they going to be left in the position of the guy who was claiming the election was stolen under the old Louisiana law?

Mr. **Taylor**. Well, you know, we had the *Arkansas Power & Light* case, and we indicated in that matter that we were going to look on a case-by-case basis, in effect, at your Long-Cannon considerations. But again, I feel very strongly that without adequate discovery—if you cannot, as you say, develop the information to make your case—then really you have not done anything for the shipper.

And that is what Dayton Power & Light was intended to do, to provide for some kind of meaningful discovery. And if we do not have that, you are absolutely right. That is really the whole point about all of this. It is fine to have all of these rules and regulations and everything else, but they are only going to work if there is proper implementation of them by people who really want them to work in the manner which Congress intended and which really we intended when they were advanced.

So I think I have to agree with everything you said. The implementation is the all-important consideration.

Senator **Danforth**. Senator Gorton.

Senator **Gorton**. Mrs. Gradison, with Mr. Taylor to comment if he wishes, if you were the owner or manager of a short line railroad what would be your objective in any car hire negotiations with a terminating railroad such as Conrail, and do you think that you could provide any leverage which would allow you even to succeed to the extent of the survival of your own railroad?

Ms. **Gradison**. Senator, I do. I think it is in Conrail's interest to negotiate rates and contracts with the short line carriers with whom they connect. If they want to participate in the traffic, they have to negotiate with the terminating or originating carriers.

At this moment we are coming out of a recession and it has been difficult for car owners to keep the equipment loaded and moving. As the economy picks up, there will become more and more demand for the boxcars and the short line carriers should have an advantage generally. They have something that the major carriers need, which is equipment.

Senator **Gorton**. Did you not just tell us that there was not any need for new boxcars until the year 1990? I do not see those two statements as remotely consistent.

Ms. **Gradison**. The short line carriers own a great portion of those boxcars, and the railroads do need them. My suggestion was that no more cars need be built until 1990. That is not to say that the equipment that is already in service is not needed. It is.

At this moment there is a surplus, but there will be shortages in the future, and the short line carriers should be able to negotiate reasonable contracts with the major carriers to use their equipment. This is an opportunity for the short line carriers, as well as a change in the way that equipment has been used and negotiated in the past.

Senator **Gorton**. Do they have any leverage whatsoever to persuade Conrail or a railroad similar to Conrail not to load and use its own cars first, other class one railroad cars next, and the short line railroads last?

Ms. **Gradison**. It depends on what they negotiate with the carrier. I would think that this would be a terrific time to make those negotiations, because there is not as much traffic as there will be, hopefully soon, and they could negotiate something now that would carry the major carrier into a time of equipment shortages; in other words, take advantage of the surplus of equipment that is available right now, negotiate at this time so that the equipment will be used later on.

Senator **Gorton**. Mr. Taylor.

Mr. **Taylor**. Well, I guess as you know, Senator, I strongly disagree. I do not think there is any bargaining equality whatsoever between a little short line railroad and Conrail or one of the bigger railroads.

I think the boxcar problem was essentially a Conrail problem, which they came in and proposed a solution to, and unfortunately, the Commission, in order to try to resolve this problem for Conrail, at least in the car hire, car service area, has come up with a proposition which I feel can have nothing but disastrous implications for particularly short line railroads.

Senator **Gorton**. Conrail is the overwhelming beneficiary of this change?

Mr. **Taylor**. There is no question about that.

Senator **Gorton** And those who deal with it are the ones who will hurting?

Mr. **Taylor**. They are really the ones who have the problem. They get an awful lot of boxcars into this area, since there is still a lot of manufacturing in the Northeast, and what do they do with them? How do they get rid of them? That is what they were really endeavoring to do, was to figure out some kind of solution to dispose of all these boxcars that are shipped in here, and how do they get them back out.

The problem is, if you are a little boxcar owner out in California and you have sent a boxcar all the way across, say on the Santa Fe to Chicago, and then into Philadelphia on ConRail, you are subject to three pretty horrible scenarios. One of them is that Conrail can send the car on up to Portland, Maine, and it can sit up there for a while. Then you may have to pay for it to come all of the way back, and if it is not going to be 35 cents a mile, why, it is only going to be something less than that because of the bargaining leverage, which I just do not see exists.

Or Conrail can put it in storage and start charging that poor little short line guy out in California unbelievable storage rates.

Ms. **Gradison**. Storage charges only counterbalance the per diem charges.

Mr. **Taylor**. But the per diem can be canceled.

Put it into storage, and then he can demand it back, but he has to pay that 35 cents per mile. I submit Senator Kasten's discussion about this being regulation and not deregulation is right on target. That is what I discussed in my dissent.

I think that there is no question that the class III railroads are really the ones who are going to suffer just enormously if this thing is left the way it is.

Senator GORTON. Thank you.

Senator DANFORTH. Senator Exon.

Senator EXON. Thank you, Mr. Chairman.

Chairman Taylor, let me go back to something that I mentioned earlier and follow up on it if I can. You several times in your opening statement and in testimony here have used the term "effective competition," and I think we are all in favor of effective competition.

Since "effective competition" is being expanded these days to include the possibility of coal slurry pipelines, which certainly would affect the railroad industry, are you in support of coal slurry pipelines to encourage "effective competition"?

Mr. TAYLOR. I think, Senator, you remember another occasion when we discussed coal slurry pipelines here in this room.

Senator EXON. I remember that.

Mr. TAYLOR. I think you know that I am a supporter of coal slurry pipelines, because I think they will provide effective competition for the railroads. As a matter of fact, the chairman and I had a little discussion back and forth at the very end of that prior hearing as to why there really was any competition at all. If the coal slurry pipeline guys were going to go in and lock the whole thing up right up front, how would the railroads ever get into the act? Where would the competition come from?

Well, the fact of the matter is that there has just been a recent story within the last few days about the Chicago & North Western.

Senator EXON. I read that story.

Mr. TAYLOR. They are not going to have their line done until 1985, and they have already locked up Arkansas Power & Light on a 20-year agreement with a 15-year option to renew that is exercisable by Arkansas Power & Light. And I think that just shows that the very possibility of a coal slurry pipeline has led to a long-term rail contract and an opportunity for the railroads to go in and offer what the utility says is the most favorable possible transportation rate they could have had.

And so to me, once again you have competition working to serve the ratepayers, because now the ratepayers of that utility are going to be able to experience costs, so far as the coal that is used for power generation, at the lowest possible rate. In that instance, it was just the mere possibility of a coal slurry pipeline which I think clearly brought this into being.

I do not know how anybody could not support that kind of a result.

Senator EXON. Do you think that if coal slurry pipelines and eminent domain rights were granted by the Federal Government, that that would affect the revenue adequacy or inadequacy of the railroads? Would that factor be taken into consideration by the ICC?

Mr. TAYLOR. Well, of course, we do not even know if we are going to be involved with the coal slurry regulation. There is a tremendous battle going on now—if legislation is enacted, who is going to have the authority and should it be ours or not. I think most of the coal slurry transportation is going to be done by contract, and the real regulation, to the extent there is any, is going to be done up front as to who gets into the business and who does not. And I think after that is done, since it will be contractually done largely, there will not really be all that much regulatory responsibility involved.

But I have always been one who has felt very strongly that the railroads can compete with coal slurry pipelines, and I think what has happened in the last few days is a clear example of that. They can and they will, and I do not think it is going to hurt them.

Senator EXON. I am not sure that you answered my question. Certainly if coal slurry pipelines ever become a reality, they would certainly affect the revenue inadequacy or adequacy of the railroads, would they not?

Mr. TAYLOR. Well, the railroads claim that, you know, it may result in irreparable injury to them. That has been their contention. That is one of the reasons, frankly, Senator, why I would like to see the ICC have the authority and why we ought to have a provision in the bill which would allow us to weigh that very, very carefully, so that if a railroad could come in with some empirical data and present information to the Commission that shows—we really are just going to be in some kind of terrible shape here, most of our profits come from coal, give us a break, give us a chance—then that could be taken into consideration.

I am not so sure, if the authority is given to the Interior Department, that that kind of an evaluation or weighing will be made. So one of the reasons I am hopeful the ICC will get it is, because we do have railroads, we can do that evaluation.

Senator EXON. All right, let me ask one more question. We did not get back to it and I am not going to have time now, but I wish that you, Mr. Chairman, could supply for the record the information that you said some of your people might be able to give us with regard to how you were going about measuring revenue adequacy or inadequacy as far as the railroads are concerned—how you figure this and what the concerns are with regard to the Burlington Northern and CSX and their purchases of other entities, as I previously referred to.

If you could submit that for the record, I would appreciate it.

[The material referred to follows:]

The Commission in March 1981 adopted a single standard for the determination of revenue adequacy—return on investment (ROI) equal to the current cost of capital. In order to improve the revenue adequacy standard, the Commission, by a Notice of Proposed Rulemaking (Ex Parte No. 393, Sub-No. 1, Standards for Railroad Revenue Adequacy, served 3/9/83), requested comments on several proposed revisions. Comments are due 9/16/83. The proposed revisions include the following:

1. Calculation of ROI to consider exclusively all transportation elements of income, expense and investment.
2. Use of normalized or weighted normalized data for four years to compute ROI.
3. Computation of ROI on a consolidated basis to include transportation affiliates of railroads.
4. Conversion from an original cost investment base to one based on current costs.
5. Use of current cost information in other regulatory proceedings.

Attached are summaries of Commission decisions in revenue adequacy and cost of capital proceedings.

The question has been asked why railroads holding large cash resources have, nevertheless, been found to be revenue inadequate by the Commission. Part of the answer lies in the distinction between cash flow and revenue adequacy.

Cash flow is a measure of the current financial position of a business, while revenue adequacy is a condition of long term viability. A business which is a going concern may generate large amounts of cash for a period of time, but, unless it retains and renews its operating capabilities, its earning power must ultimately decline. The mandate of the Commission is to provide the railroads with the opportunity to earn sufficient revenues to ensure their long term survival as as essential part of the national transportation system.

Earnings which economists generally regard as adequate to maintain long term viability are those which equal the cost of capital. Investments which do not recover their costs will, at some point in the future, be denied additional investment needed for asset replacement. Recognition of this fundamental principle of economics has led the Commission to adopt return on investment (ROI) equal to the cost of capital as the conclusive test of revenue adequacy. The fact that virtually all railroads currently fail this test does not alter its validity. It remains the goal essential to their survival and the Commission is mandated to help them strive for its attainment.

The cash and credit available to the railroads may be a misleading indicator of their financial health for reasons other than the transiency of such resources. Cash may be provided by neglect of necessary capital and maintenance expenditures; credit may be available only under unfavorable terms and conditions. (Both long term debt and new equity issues for railroads have been conspicuously absent from the financial markets in recent years.) Cash reserves created through the retention of earnings by the railroads may indicate a shortage of promising re-investment opportunities within their own industry. Another source of cash may be partial liquidation through sale of capital assets.

Senator EXON. Let me ask you a question in this regard. Your staff conducted a study recently wherein it contacted many of the major financial brokerage firms in the United States, and these firms responded that they placed very little, if any, weight on historical rate of return in judging the financial health and investment potential of the rail carriers.

What is your opinion, as Chairman, of the staff study as it affects the financial health of individual railroads?

Mr. TAYLOR. Would you mind if I asked our Bureau of Accounts Director Ron Young to respond to that?

Senator EXON. I would not mind. I am talking particularly about Ex parte No. 393, which you referred to briefly.

Mr. TAYLOR. Sub 1. And we will provide for the record some comments on that, so you have a full background on it, and on Ex parte No. 347 as well, and keep you posted on the market dominance area.

[The material referred to follows:]

Details regarding the Commission's proposed revisions to improve the revenue adequacy standard (Ex Parte No. 393, Sub-No. 1) are set forth in our record response to a prior question.

By order served 2/24/83, the Commission issued proposed guidelines for prescribing maximum reasonable rates, Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines. The Commission is presently reviewing comments received by interested parties, which were due to be filed on 7/28/83.

A summary of the Commission's decision follows.

The decision proposed guidelines for prescribing maximum reasonable rates for captive coal traffic. Under the Proposal, the Commission would adopt a "constrained market pricing" approach in evaluating maximum reasonable rail rates on the coal traffic of "captive" shippers, i.e., those having no other effective means of coal transport. Rail rates on captive coal traffic would be subject to four upward constraints:

"Stand-alone" cost. The cost of any given shipper (or shipper group) is the cost of serving that shipper alone, as if it were isolated from the railroad's other customers. It represents the level at which the shipper could provide the service itself, and is the point at which cross-subsidy would begin to take place. These costs are defined as the long-run average costs for the optimal capacity required by the stand-alone shippers.

Management factors. Certain statutory factors that must be considered in the determination of rail rate reasonable. First, the Long-Cannon provisions of the Staggers Rail Act of 1980 stipulate that the railroad, not captive shippers, must bear the burden of pricing inefficiencies. Second, where a rail carrier fails to conform to generally accepted standards of honest, economical, and efficient management, the railroad, not the captive shippers, must bear the cost of such inefficiencies.

15-percent phase in. The proposal generally would not permit rate increases on captive coal traffic of more than 15 percent per year, after inflation. The 15-percent figure is cumulative, so that any deferred increase can be taken in another year.

Revenue adequacy. Until a rail carrier achieves revenue adequacy, it would be free to adjust its rates unless it violates one of the other three constraints. The proposed definition of revenue adequacy would be long run to accommodate yearly fluctuations.

Mr. YOUNG. Senator, Chairman Taylor has never seen that study, and as a matter of fact, he is not aware of it, I do not believe. That study was done before he became Chairman, before he came to the Commission, and it was done prior to the initial adoption of Ex parte No. 393 where we went to a return on investment standard for revenue adequacy purposes.

I had my staff do that study at the time we were considering the simple return on investment standard or using several different ratios to evaluate revenue adequacy. And we did contact several people on Wall Street to ask how they evaluated firms and investments, and your characterization of that is precise.

The difference is between what the Commission is doing and what people on Wall Street do is that our standard is a longrun standard. We are looking at the long-range outlook of the firm, and over the long run is it earning a competitive return in the marketplace, whereas the people on Wall Street are looking at the firm and the investments over a shortrun basis, the next few months, the next 6 months, the next year, and how the firm is stacking up with other firms in the industry in terms of investing in stocks and bonds.

The Commission's position in Ex parte No. 393 was that the firms have to earn an economic return, and the economic return is considered return on what you put into the firm, and that is the current cost of capital, and that is the longrun measure that we are using now, and that is why there is a difference between those two. We went with the longrun versus the shortrun standard at the time.

Senator EXON. Well, I think the Chairman should see that study if he has not seen it. We are getting right into the heart of the matter, into the concerns that many of us have with regard to the narrow definition of railroad revenue inadequacy as defined by the Commission. So I suggest that the Chairman should see that.

Mr. YOUNG. Well, he certainly will.

Mr. TAYLOR. I can assure you I will, Senator.

Senator DANFORTH. Chairman Taylor, do you know if anyone, for any purpose, whether it is on Wall Street or anywhere else, uses return on the current cost of capital as a measure of profitability?

Mr. TAYLOR. That is what we used. The extent to which it is used elsewhere—it is not used that way in the utility field. I was involved in utility regulation for a good long time.

Senator DANFORTH. It is an unusual measurement of revenue adequacy or profitability, is it not?

Mr. TAYLOR. Well, I would not say that it is unusual. We felt that it was realistic under the——

Senator DANFORTH. Is that a test that is used for any accounting purpose or any financial analysis purpose?

Mr. **Taylor**. Let me pass that back to our Bureau of Accounts director. If anybody knows, he does. I am not aware of anybody else who does.

Mr. **Young**. Let me try to address it in some fashion.

We have done a survey of the public of about 64 public utilities around the country, and in one fashion or another they do use a current cost of capital, perhaps not on the entire investment but some firms, some public utility commissions will use the current cost of equity capital and the embedded cost of debt. Some will use the current cost on a current value net investment base. Most of the economic thinking that was presented to the Commission when we looked at our decision in Ex parte Nos. 393 and 347 was that in order to allow the railroads to earn a competitive return, we should allow that to be the current cost of capital; that is, what they would earn if they would take that money and put it someplace else.

And if we allow them to earn that current cost of capital on their investment in the firm, the money will stay in the railroad industry as opposed to being divested into other industries. And that is the economic thinking behind allowing them to earn the current cost of capital. The embedded debt rates that the railroad industry and others have in their structure are quite low, and when you look at interest rates today compared to what their embedded rates are, there could be an incentive to disinvest if we did not allow them to earn the current cost of capital on that.

Mr. **Taylor**. There is another comment I think that should be made. We do not use the embedded cost of debt; we use the current cost of debt, because for a lot of railroads the embedded cost is very, very low. But the whole purpose is to allow the railroads to be able to attract capital.

Now, you know, for a long, long time the railroads have not been a very attractive investment. Right now there are a few on Wall Street who are saying, hey, maybe a railroad is a good buy. The Norfolk Southern seems to be doing fairly well, and so on. Despite the fact that they are not revenue adequate by our standards, they are doing a hell of a lot better than they have been on a relative basis.

But I think the whole idea was that if railroads are going to be able to attract capital, they have got to have some kind of a standard that they can use in order to accomplish that. And so maybe it is a little bit more liberal than——

Senator **Danforth**. The reasoning for the determination of revenue adequacy has to do with the degree to which the Commission has any impact on the rates charged by the railroad.

Mr. **Taylor**. I think that is correct.

Senator **Danforth**. But what if you have a standard of revenue adequacy which would indicate that no one is ever revenue adequate?

Mr. **Taylor**. That is not the intent, to have a carrot in front of the donkey that the donkey never gets to catch up with.

Senator **Danforth**. Is that not necessarily the effect of replacement cost of capital? I mean you do not now factor in depreciation at all.

Mr. **Taylor**. We have just completed a proceeding insofar as trackage is concerned to put that on the regular depreciation basis, and we think that is an adequate proposition, too. That is another subject.

But I think the important thing to keep in mind is that we have just come from an era when everybody was considering the possibility that the railroads might become wards of the Government, and everybody wanted to avoid that. They do have to have capital, and if they are going to be able to attract capital, they have got to have some kind of a standard pursuant to which that can be done.

And so we looked at the current cost of capital as really the only meaningful proposition for them. That is why——

Senator **Danforth**. You are not investment analysts, though. You are regulators.

Mr. **Taylor**. No, but I think the statute talks about the fact that we should see that the railroads are able to attract capital, and using that as our guideline, this is the standard that we have come up with.

Senator **Danforth**. Senator Kassebaum.

Senator **Kassebaum**. Thank you, Mr. Chairman.

No questions.

Senator **Danforth**. Senator Long.

Senator **Long**. I heard the answer to Senator Danforth's question—I think I heard it—but I for the life of me cannot understand it.

Now, let me just put that in a way that I understand. I am selling gas, natural gas, under an old contract for $3 a thousand, but under that contract let us say I could get less a thousand for it. What you are saying is that by your logic, the guy who buys that gas from me at 30 cents or even 3 cents would be permitted to charge $3 in the rate base, 10 times or even 100 times what he is paying me for it, and pass that right on to the consumer just as though he paid $3 when all he paid was 30 cents or maybe 3 cents.

Now, the way I understand regulation—and it has been a long time, and I have forgotten much of it, I am sure—these people used to be entitled to make a fair return on their investment. That meant a fair return over and above their cost.

Now, any company that has been around here a long time, if they borrowed money, has some old notes out there, and is entitled to make a profit over and above the interest expense. Who else on Earth comes up with a concept that you are supposed to be able to make a profit over and above an expense that you have not paid? Who else does that on anything, including money? Who else does that?

Mr. **Taylor**. Well, Senator, we used to look at the embedded cost of debt. Just a couple of months before I arrived at the Commission, I think in March 1981, there was a proceeding in Ex parte No. 393 which tossed that out, so we do not consider it now. We look at the current cost of debt.

But we have a proceeding, Ex parte No. 393 (Sub-No.1) which is now open and there and available for comments. I think you have until September 16 for anybody who is really interested in addressing it. The whole idea is——

Senator **Danforth**. You just got a pretty good comment.

Mr. **Taylor**. We did, and that will be taken into account, I can assure you. It is not final yet.

Senator **Long**. That situation reminds me of a situation I once encountered during my experience as a lawyer where a couple had a difference of opinion about the way the wife kept the household accounts. She would go down the street and pick out a very expensive hat in the window, and she would say: "Gee, I would love to have that hat. But, you know, I do not have to have that expensive a hat. I can have this hat that costs half that much." So she would write a check for the hat that cost half as much, and she would write herself a second check for the difference and put that in her private account on the theory that she had saved that much money. It did not take long to put a lot of money in the private account of her own just because she was saving all that money in shopping—the difference between what she would liked to have bought and what she bought by economizing.

That is about the kind of thing it sounds like to me when you are talking about letting these people charge based on whatever it costs if they are borrowing the money now. That is not what they are paying.

Now, let me ask you, since the Long-Cannon amendment went on the statute books, has there been a case in which the ICC has found the railroad was inefficient or has found a rate excessive based on the criteria in that amendment?

Mr. **Taylor**. The only possible case that I can think of is the *Indiana* case where the State made such a finding. The ICC, to my knowledge, has never found that.

Senator **Long**. Well, the ICC did not.

Mr. **Taylor**. The ICC did not, and I dissented in the *Indiana* case. I was by myself on that. I though the carrier had done an inadequate job, and the State came up with some concerns of that kind. But to my knowledge, the ICC has not so found.

Senator **Long**. Now, this amendment provides that the ICC shall consider evidence on certain matters. What has the Commission done in order to bring that evidence before the Commission?

Mr. **Taylor**. Are we talking Long-Cannon considerations again?

Senator **Long**. Yes, sir.

Mr. **Taylor**. I think in the *Arkansas Power & Light* case we indicated we would endeavor to do it on a case-by-case basis. And in order to see that it can be done and that the shipper has the opportunity to come up with the information that he needs to make his case, we wanted to provide adequate discovery on a case-by-case basis, which we endeavored to do in the *Dayton Power & Light* case. So I think that is where we are at the moment—endeavoring to do it on a case-by-case basis and make opportunities available to shippers through adequate discovery.

Now, we have not come out with a whole lot of comprehensive guidelines and standards as to exactly what you have to do up front in order to make your case, and presumably as we move along on a case-by-case approach, some standards will evolve.

Senator **Long**. Let me just say this, Mr. Chairman and members of your Commission, you can quarrel about precisely what that Long-Cannon amendment means and how it is to be applied by the Commission. But you have the language in the statute, and that amendment provides it to you, that you can protect the public from outrage if you want to do so. Under that language you can prevent the captive shipper and the captive customer from being victimized.

Now, it is easy enough to make something work if you want it to work—you have the language. Now, if you do not want it to work, it is easy enough to see that there is no protection.

And I am concerned about putting the burden on the utilities to prove that the other fellow is not doing a good job or to prove what his costs are when if they had the same burden of trying to prove that they are entitled to a rate increase, they would have to come up with all the evidence.

Now, it seems to me that to put the burden on the utility to try to prove that a million customers are being victimized out there is contrary to the intent when the facts to prove it are in the possession of the other guy. The carrier ought to be required to prove that he is operating efficiently and produce the evidence. And certainly if the Commission is not going to make him do this, it at least ought to see to it that those who are representing as many as a million consumers at a time have a right to look at the carriers' books and see what those books show.

I do not think you have done it so far. Can you say it has been done?

Mr. TAYLOR. Well, I hope it is in the process of being done. That is where I hope we are with it. Because I agree with you; I think implementation, as I responded to Senator Exon, is all important. We do have the machinery in the law. You specifically and Congress as a whole gave it to us. And to me it is very important that it be implemented. At least as far as my vote on the Commission is concerned, I would hope that it will be.

I think, again, it is a matter of implementation. You can have all the laws in the world, and if you have a Commission that does not really want to implement them the way Congress intended, it is not going to make a bit of difference. That is really where we are with it. And I think that in due course proper implementation will be afforded Long-Cannon. At least that is going to be my posture.

Perhaps Commissioner Gradison would like to address it as well.

Ms. GRADISON. We are moving forward in attempting to implement the meaning of Long-Cannon. I have been at the commission for a year. We are implementing the Long-Cannon provision on a case-by-case basis. We have not come up with a general ruling. As we establish standards on a case-by-case basis we may decide that a rulemaking is required, but to this date we have not had a need nor an opportunity to do so.

Senator LONG. Well, it seems to me that——

Ms. GRADISON. Long-Cannon is one of the factors in our maximum coal rate guidelines. It is clearly a factor that we have to take into consideration.

The coal rate guidelines, as has been stated, are a proposal. They do not represent the final rules. This is again the fourth attempt to come up with some kind of guidelines for coal rates. And we are trying to use what you gave us to work with, and so we put Long-Cannon in the guidelines, and in each case we will look at it.

Senator **Long**. Well, let me say this to each of you on this Commission: My greatest complaint about the job I have is that we start out with a purpose that we want to achieve, and we pass a law to achieve it. Then we have to pass a second law and a third law and a fourth law to do what the first law is intended to do in the first instance.

Now, the language is there. In my judgment the language is there. If the Commission wants to protect the public interest, it can do so; if it does not want to protect the public interest, that is different. And, frankly, it is a public issue. You folks do not run for public office, but the guy that appoints you runs for office—at least there is one man around here who is still thinking about running for office. And this is a policy somebody has to answer for at some particular point.

And each one of you, I am sure, is sworn to do your duty as the good Lord gives you light to see it, and I think you are going to do it. But mark my word, in this area dealing with the captive shipment of coal, unless this Commission does a job as that amendment intended, the Commission is going to be severely criticized, and everybody who is involved will be severely criticized until we get this matter where it ought to be. Because it is not fair and it is not right that just because people have no option but to have a railroad carry their coal, they should have to pay a great deal more than justice and conscience would dictate.

And they look to us to protect them in situations like that, and in turn, we look to you.

Mr. **Taylor**. I agree with you, Senator, and hopefully we will be able to afford that degree of protection. I think that is our role, particularly, as we have talked earlier, in the case of the captive shipper. And that is what you have. And as I pointed out in the export coal case, 95 percent of those mines are located on one rail line, and I think they are captive. That was one of the problems that I saw in that matter.

So I think we will keep your admonition in mind.

Senator **Danforth**. Chairman Taylor and Commissioner Gradison, thank you very much for an extended stay this morning.

Mr. **Taylor**. Thank you, Mr. Chairman, and members of the subcommittee. I appreciated being here.

Ms. **Gradison**. Thank you very much.

[The statement follows:]

STATEMENT OF HON. REESE H. TAYLOR, JR., CHAIRMAN, INTERSTATE COMMERCE COMMISSION

Mr. Chairman and Members of the Subcommittee, I want to thank you for this opportunity to present the views of the Commission concerning the implementation and effects of the Staggers Rail Act of 1980. In addition to the following statement, we have included: (1) a table listing the status of the Ex Parte proceedings conducted pursuant to the Act; (2) a brief summary of each of these proceedings; and (3) a brief summary and list of all litigation involving the Staggers Act.[1]

The Staggers Act represented the second major effort in five years to resolve the continuing problem of railroad revenue adequacy.[2] This legislation has substantially reduced Federal regulation of the rail industry, while providing rail carriers with the opportunity to obtain adequate earnings. The Act was intended to assist the rail system to remain viable in the private sector of the economy and to allow the railroads to compete more effectively among themselves and with other modes of transportation.[3] To assist in the revitalization and modernization of the rail system, the Staggers Act encourages competition, provides for the prompt recovery of costs, promotes greater rate and service flexibility without government interference, and emphasizes the need for adequate rail revenues. While there is greater reliance on the forces of the marketplace, a regulatory process remains to balance the needs of carriers, shippers, and the public where warranted, such as in the absence of effective competition.

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[1] Appendices I, II, and III, respectively. (Retained in committee files.)

[2] The first was the Railroad Revitalization and Regulatory Reform Act of 1976 (the 4R Act).

Given the Act's overall mandate, the Commission conducted numerous proceedings, many of which were required specifically by the statute. In our view, the Staggers Act and our implementation of it have been generally successful in removing unnecessary regulation, encouraging efficient carriers to earn adequate earnings, and balancing the interests of the parties in accordance with the goals of the Act. The ultimate result, we believe, will be a more healthy, competitive rail industry with benefits accruing to all concerned. The freedoms accorded the carriers under the Staggers Act have enabled the railroads to adjust their rates more quickly for inflationary increases in costs and to implement new marketing techniques. For example, since the Commission last testified in November of 1981, two inflation-based rate increases have become effective, a 4.7 percent increase effective on January 1, 1982, and a 1 percent increase effective January 1, 1983.

It is difficult to provide a definitive assessment of the Act's impact on the financial condition of the rail industry at this time. This is due to the fact that the railroads have suffered from the recent recession. Nevertheless, we are confident that the Act has helped the industry to fare comparatively well considering the magnitude of the recession. We now possess more experience in implementing the Act than we had at the time of our last testimony. The key rulemakings mandated by the Act have now been completed. Through our experience, as well as the passage of time, we are able to ascertain more clearly some of the effects of the Act. Has the Act had a positive effect on the railroads' financial condition? We believe it clearly has had such an effect.

Earnings of Class I line-haul railroads for the first twelve months after passage of the Staggers Act (October 1, 1980, through September 30, 1981) increased substantially from the prior twelve-month period. In the first year after enactment, operating revenues increased 11.5 percent to $30.7 billion. This was due primarily to greater rate flexibility, since freight revenue ton-miles increased only about one-half of one percent. In addition, net railway operating income rose 55.3 percent, to $1.7 billion from $1.1 billion. Subsequently, there was a decline in revenues, earnings, and volume of traffic during the fourth quarter of 1981. Nevertheless, despite this decline, 1981 industry earnings—in terms of net revenues and ordinary income—showed increases over the previous year.

Recent financial results have not been as favorable. The Commission's latest earnings report for the Class I railroads shows that revenues, earnings and traffic volume in 1982 declined from 1981 levels, as follows:

Operating revenues decreased 11 percent to $27.5 billion and revenue ton-miles of freight declined 12.3 percent.

Net railway operating income declined almost 45 percent to $767.7 million and net income before extrordinary items decreased 41 percent to $1.2 billion.

Rate of return on net investment in transportation property declined to 2.19 percent from 4.17 percent.

The recession severely affected railroad traffic and earnings during 1982. Considering the magnitude of the recession, however, as we mentioned earlier, the industry fared quite well, and we believe the long-term outlook for the industry as a whole is very favorable. The Staggers Act, the Commission's continuing implementation of the Act, the Economic Recovery Tax Act of 1981, and consummation of several major rail mergers have all contributed to strengthening the financial structure of the industry. While the overall rate of return on investment is still far below adequate levels, it has risen well above the level of the mid-1970's and should continue to improve as the economy recovers.

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[3] The goals of the Act, as set forth in section 3, are as follows: (1) to assist the railroads of the Nation in rehabilitating the rail system in order to meet the demands of interstate commerce and the national defense; (2) to reform Federal regulatory policy so as to preserve a safe, adequate, economical, efficient, and financially stable rail system; (3) to assist the rail system to remain viable in the private sector of the economy; (4) to provide a regulatory process that balances the needs of carriers, shippers, and the public; and (5) to assist in the rehabilitation and financing of the rail system.

Thus, we remain convinced the Staggers Act can be credited with a significant improvement in the railroads' financial position. Although the recession of the past year has undoubtedly affected earnings, we believe the effects would have been more severe had the Staggers Act not been enacted. Use of the inflation-based increase provision generated significant revenues for the industry and helped prevent even greater declines in earnings. Additionally, in many instances, the carriers have discontinued noncompensatory services or made such service compensatory by corrective pricing measures.

It took, we feel, the Staggers Rail Act to imbue individual carriers with the independence to make needed changes. In particular, the strict constraints on collective ratemaking should serve to encourage individual pricing changes to fit market conditions. The new freedoms for unilateral changes in joint rates aimed at eliminating noncompensatory divisions and uneconomic joint rates, and the contract provision should have a similar effect. And, while fewer carrier systems are emerging from the current merger movement, we feel that conditions are presently more competitive than prior to the Staggers Act due to the decrease in collective ratemaking and the increase in independent actions.

The use of the rail cost adustment factor has done much to help carriers keep up with inflation without being burdened by the heavy litigation cost and delay involved in many past general increase cases. As carriers and shippers adjust to the new pro-competitive environment with more innovative marketing methods, including greater reliance on contracts, a more vigorous and financially viable railroad system should emerge.

Mergers have also played an increasingly important role since we last testified on rail matters. Four major consolidations have been consummated since passage of the Staggers Act. These include: (1) CSX Corporation's control of the Chessie System and Seaboard Coast Line Industries; (2) Burlington Northern Inc.'s merger with the St. Louis-San Francisco Railway; (3) Norfolk & Southern's control of the Southern Railway and Norfolk & Western Railway; and (4) Union Pacific Corporation's control of Missouri Pacific and Western Pacific. In addition, the Commission has approved control of the Boston and Maine by Guilford Transportation Industries, Inc., and it has also permitted Guilford to acquire control of the Delaware and Hudson. While none of these was technically decided under the provisions of the Staggers Act because they were pending prior to its enactment, the competitive criterion added by the Act has long been considered in Commission decisions and was an integral part of our analysis in all of the above consolidations.

As to the future, it appears that the current merger movement will continue. The efficiencies and economies resulting from single-line or single-system operations will lead, in all likelihood, to the creation of a few transcontinental systems. While we believe the restructuring will assist in the attainment of the goals of the Staggers Act, we want to assure you that any proposal presented to us will be carefully considered in light of the statutory criteria.

Another way to judge the impact of the Staggers Act is by how often its provisions are utilized. Unlike the period following the 4R Act when little happened, there has been major activity in a number of areas under the Staggers Act. For example, as of mid-June 1983, 7,844 rail rate contracts had been filed with the Commission since the effective date of the Act.[4] We now receive about 530 new contract rate filings per month by all sizes and types of rail carriers on a wide variety of commodities. Contracts have been filed by 115 railroads including both large Class I carriers and small short lines and switching carriers. The most active railroads in the contract rate area include the Chicago and North Western (1716), Southern Pacific (1081), Union Pacific-Missouri Pacific-Western Pacific (933), Conrail (477), Burlington Northern (477), Chicago, Milwaukee, St. Paul and Pacific (411), Missouri-Kansas-Texas (289), Norfolk Southern (286), and the Santa Fe (277).

Contracts cover a wide range of commodities, subject to a variety of rate and service agreements, involving such areas as car utilization, guaranteed car supply, guaranteed service, volume allowances, stable rates, truck competitive rates, and preservation of rail service. A rough breakdown of contracts by major commodities shows:

	Contracts	Percent
Commodity group:		
Grain/grain products	1,033	13.2
Coal	349	4.5

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[4] This figure exceeds 8,000 as of July 1, 1983.

	Contracts	Percent
Forest products, lumber, paper	1,562	19.9
Autos, parts, machinery, implements	273	3.5
Iron and steel, metals, scrap	887	11.3
Foodstuffs	984	12.5
Bulk chemicals and minerals	1,769	22.5
All others—service, miscellaneous, and so forth	987	12.6
Totals	7,844	100.0

The duration of these contracts ranges from one week to 39 years, with an average duration of approximately three years.

The Commission issued final rules for filing contracts (Ex Parte No. 387) which became effective on January 4, 1983. These rules have been challenged in the United States Court of Appeals for the Second Circuit by the Water Transport Association, joined by several ports and agricultural shippers (*WTA* v. ICC, No. 82–4182). The matters at issue involve the rights of water carries to challenge contracts and the information available to the public in contract summaries.

Only a few contracts have been rejected for short notice violations or retroactive provisions. In this respect, the Commission issued rules (Ex Parte No. 387, Sub-No. 200), effective June 27, 1983 to allow contract provisions to become effective on the date the contract is filed with the Commission, subject to ICC 30-day review and approval.

To date, we have not experienced problems with respect to the carriers' statutory common carrier obligation vis-a-vis contract filings. In fact, only two protests have been filed challenging contracts on the basis of alleged conflicts of the commitments proposed with the common carrier obligation. The Commission decided in those instances that the facts as presented did not warrant an investigation.

The Contract Advisory Service created by the Staggers Act has met with officials of most major railroads and hundreds of shippers. It is the focal point in the Commission for contract information and technical assistance as contract activity increases. The Advisory Service has developed a mailing list of more than 2,500 interested shippers/carriers for dissemination of non-confidential contract summaries and information, as required by the Act.

Also used extensively since our last testimony are the surcharge and joint rate cancellation provisions of the status. These provisions [section 217 of the Staggers Act and 49 U.S.C. 10705(e)] have been instrumental in giving carriers expeditious relief from noncompensatory rates and divisions. For fiscal year 1982, we identified 117 surcharges and negative surcharges that became effective. Of these, 93 were commodity-oriented and 24 were imposed on light density lines. Annual net revenues added by these surcharges total approximately $11.4 million. While totals for fiscal year 1983 are not yet available, it appears that the level of activity has increased.

As reported in our Joint Rates Study, which was submitted to Congress on November 12, 1982, it appears that joint rate cancellations are becoming the major tool used by carriers to achieve joint rate relief. For fiscal year 1982 and for the first half of fiscal year 1983, cancellations protested before the Commission totaled 24 and 15, respectively. While these numbers appear relatively small, many of the cancellations have very board application. Our experience indicates that most parties have been able to adjust adequately to cancellations affecting them. Nevertheless, we are aware of substantial concern expressed over certain cancellations. As a result of this concern and out own interest in monitoring how cancellations have begun altering the joint-rate structure, the Commission has directed its Office of Transportation Analysis to undertake a study of the joint rate cancellation issue.

As for the use of the saving provision (i.e., section 229 of the Act) shippers timely filed 864 complaints under this provision. As of July 1, 1983, 682 have been dismissed, due to settlements reached by the parties in most instances. Of the remaining 182 cases, about 60 percent (at least 109) are likely to be settled. Of the remaining 73, 31 are not being held up at the request of the complainant, or are intrastate in nature; 4 are in the record-building stage with special procedures; 1 is being handled under our modified procedure; and 57 have been assigned to administrative Law Judges for handling or decision. The latest continuing Report on the Docket Management of these compliants is attached as Appendix IV to this statement.

Another important Staggers Act change is the expansion of the Commission's exemption authority under 49 U.S.C. § 10505. The Commission is required to use its exemption authority when the Commission finds that regulation is unnecessary to effectuate the rail transportation policy of section 10101a; and either (1) the transaction or service is of limited scope; or (2) regulation is not necessary to protect shippers from the abuse of market power.

Since passage of the Staggers Act, the Commission has modified and streamlined its exemption procedures. We have finalized the exemption of most railroad TOFC/COFC traffic. The TOFC/COFC exemption, which has been affirmed in all significant respects by the Court of Appeals for the Fifth Circuit, has proved very beneficial, as has the earlier exemption of fresh frutis and vegetables. According to reports we have received, many rates on fruits and vegetables and TOFC/COFR are lower, and service has substantially improved since the Commission approved these exemptions. We expect similar results from our decision to exempt agricultural commodities (except grain, soybeans, and sunflower seeds), liquid iron chloride, iron sulphate, and hops. Exemptions for frozen foods, storage and surplus cars, and a group of manufactured commodities are now under study.

The Commission has actively employed its rail exemption authority to reduce further unnecessary regulation in other areas as well. In the finance area, we have granted hundreds of exemptions for individual rail transactions where the transportation or public impact was minimal, or our regulations was not needed to protect shippers from an abuse of market power. The range of exempted transactions includes securities issuances, abandonments, lease and trackage rights agreements, new operations, acquisitions, and certain classes of transactions, such as mergers of a subsidiary into a parent company. As a practical matter, these transactions are rarely opposed (except by labor, which requests the standard protection conditions), and such transactions are routinely approved. Exempting these transactions from regulation enables the railroads to avoid the delays, extensive paperwork and expense involved in preparing and processing applications for Commission approval of minor transactions.

This spring, the Commission removed a 99-year-old rule which had governed rail rates subject to the so-called long-and short-haul provisions. We exempted railroads from seeking prior Commission approval for establishing lower rates on long-hauls than on short-hauls when the shipments move in the same direction. This exemption was based on Commission findings that changes in the transportation industry, including the rapid growth of intermodal competition, have all but eliminated the problems that the long-and-short-haul clause was intended to remedy.

Recently, the Commission approved two other exemptions for boxcar and export coal movements.The former excludes from rate regulation the rail transportation of all commodities moving via boxcar except nonferrous recyclables. The decision also authorizes the railroads to impose charges for storage and return of empty boxcars and, at their option, to negotiate bilateral car hire agreements to apply in lieu of car hire rates prescribed by the Commission.

The export coal decision is effective September 12, 1983, and will exempt all aspects of export coal transportation from regulation.[5]

Effective competition is the key to the success of the Staggers Act and its implementation. An environment where efficiency, flexibility, and adequate revenues are encouraged will promote such competition and the related benefits. The Commission is implementing the Act with this in mind. Where there is a lack of effective competition, the Commission will continue to provide captive shippers protection against unreasonable rates. Meanwhile, by eliminating burdensome regulations and practices which tended to stifle innovative rail management, the Commission is attempting to promote more efficient operations. The elimination of the old "DT&I merger conditions" will result in more efficient routing and pricing,[6] as well as the elimination of unnecessary trackage. Innovative ratemaking and marketing have been encouraged and supported. The direct connector restriction imposed in collective ratemaking and the emphasis on independent actions and contracts will result in more competitive rate levels. Eased requirements for constructing and operating new rail lines, and mandatory reciprocal switching agreements, where warranted, will result in stronger intramodal competition. Rail lines formerly in financial difficulty, such as the B&M Corporation and the D&H Railway Company, have been revived, and will offer extended service and competition in their region.

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[5] At present, the exemption applies to export coal from American ports. Requested comments have now been filed and are under consideration with regard to the applicability of the exemption on coal transported to Canada and Mexico.

[6] See following section of this statement for further discussion of the DT&I conditions.

In sum, we believe that the Staggers Act is working and working well. I would like to turn now to a more in-depth discussion of particular provisions of the Act and the Commission's implementing decisions.

Title-by-Title Analysis of the Implementation and Effects of the Staggers Act

TITLE II—RAILROAD RATES AND INTER-CARRIER PRACTICES

This title provides the railroads with substantially more rate freedom than was afforded prior to the Staggers Act. Generally, in the absence of market dominance, a rail carrier may establish a rate at any level it desires (absent discrimination) so long as it contributes to going concern value. The title also establishes a revenue-variable cost threshold below which the Commission has no jurisdiction over the reasonableness of rates. If the carrier has market dominance and the rate exceeds the jurisdictional threshold, the Commission, on complaint or protest, is authorized to determine whether the rate is reasonble.

In determining whether a rate is reasonable, the Commission is required to recognize the policy that rail carriers are to earn adequate revenues. Basically, this title eliminates rate regulation where there is effective competition. It also encourages carriers to use new marketing techniques such as contracts, permissive limited liability rates, and premium or reduced charges to encourage better car utilization. Surcharges are permitted without the concurrence of other parties of the joint rate to assure that carriers may earn revenues of 110 percent of variable costs or may close routes not providing this level of earnings.[7] Provisions in this title also simplify coordination, minor merger procedures, entry, and reciprocal switching agreements. Finally, title II requires the Commission to utilize its expanded exemption authority so as to regulate only where necessary to protect against abuses of market power.

In order to implement this title, the Commission conducted over 30 ex parte proceedings. Appendix II to this statement provides a brief summary of all of these proceedings. At this point we would like to discuss some of the more far-reaching and pivotal of these decisions.

Ex parte No. 320 (sub-No. 2), market dominance determinations and considerations of product competition

Accurate market dominance determinations are central to fulfilling the goals of the Staggers Act, namely, that competition and demand for services are to be the determining factors in railroad ratemaking except where there is an absence of effective competition.

Ex Parte No. 320 (Sub-No. 2) reflects the provisions of the Staggers Act and our experience to date with the market dominance rules established pursuant to the 4R Act. Basically, the proceeding had two purposes: (1) the reexaminaton of existing market dominance regulations; and (2) a determination, as mandated by section 205 of the Staggers Act, whether and to what extent "product competition" should be considered in determining the reasonableness of rates.

Our decision in this proceeding eliminates the prior rebuttable presumptions of market dominance based on cost, market share, and substantial investment. The presumptions have been replaced with general guidelines. Because of the wide variation in circumstances from case to case, we believe the flexible approach we have adopted will provide a more useful and reliable method for determining the railroads' market power in a given situation.

With regard to product and geographic competition, we concluded that these factors should not be considered in our reasonableness determinations. Since such assessments are based primarily on a comparison of the challenged rate and the cost of a movement, consideration of product competition (which has little, if any, bearing on costs) would provide no additional insight. Moreover, product competition would be difficult to quantify in this context. In our view, the concept is more relevant as an evidentiary tool to be used, as we have in the past, in determining whether a carrier is market dominant vis-a-vis particular traffic.[8]

In *Western Coal Traffic League* v. *United States,* 694 F.2d 378 (5th Cir. 1982), the court in a 2-to-1 decision held that the Commission is prohibited from considering evidence of product or geographic competition in making a determination of market dominance. A rehearing en banc was granted and the case was reheard on June 6, 1983. Accordingly, our current guidelines regarding product and geographic competition are still in effect. A decision by the court is expected in the next several months.

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[7] Except for light density lines, the authority to establish surcharges expires in 1983 unless extended for one additional year by the Commission.

[8] Under our prior regulations, product and market competition were not considered germane in computing market share, but such evidence could be introduced to show that effective competition existed.

Ex parte No. 399, cost recovery percentage

Section 202 of the Staggers Act required the Commission to calculate, within six months of passage of the Act and annually thereafter, the cost recovery percentage (CRP) for all rail traffic. The Act defined the CRP as that ratio of revenue to variable cost which, if all rates above it were deemed to have produced only revenues resulting in the cost recovery percentage, would, in the aggregate, when combined with total revenues from other traffic, provide revenues sufficient to cover industry-wide variable plus fixed costs (including a return to equity and debt, calculated at the embedded debt level). The CRP would not have an actual regulatory use until October 1, 1983, if the CRP is less than 175 percent, or October 1, 1984, if it is above that level, at which time it becomes the threshold revenue/variable cost level for assertion of Commission jurisdiction over rail rates. The statute further prescribes that in no event can the CRP be less than 170 percent or more than 180 percent.

For purposes of meeting the six-month statutory deadline, the Commission decided to use the Rail Form A costing methodology to set the initial CRP level. Before October 1, 1983 (the earliest date on which the CRP could become effective), the Commission hoped to revise the decision to reflect changes and improvements in costing techniques, such as adoption of a new Uniform Rail Costing Methodology.

The original Commission decision was issued on April 1, 1981, and set the CRP at 197.5 percent. Since the statute prohibits the CRP from being set higher than 180 percent, it would, if actually in effect, be set at that level. The decision explained in some detail how the figure was derived, and noted that it reflected a large volume of traffic now moving at rates below variable cost. The decision expressed the view that, with passage of the Staggers Act and changes in joint-rate procedures and minimum rate standards, there will be considerably less traffic moving variable cost, and that the CRP will be correspondingly lowered.

In a notice served March 26, 1982, the Commission announced that it would consider using the new Uniform Rail Costing System (URCS) for the calculation of the 1982 CRP. Release of the 1982 CRP was anticipated on or before September 1, 1982, so that there would be a sufficient period for comments. Unfortunately, the final implementation of the URCS system has been delayed. Accordingly, in a decision served December 13, 1982, the Commission set the 1982 CRP at 183.5 percent computed by using 1980 Rail Form A regional unit costs updated to a 1981 level and movement data from the 1981 waybill tape—the latest data available. Once URCS is available, a decision concerning whether to use URCS or Rail Form A for future calculations will be made.

Ex parte No. 393, standards for railroad revenue adequacy

The Staggers Act and its legislative history emphasize the railroads' need for adequate revenues in order to meet the demands of interstate commerce. While the statutory definition of revenue adequacy was not changed,[9] the Act directed the Commission to conclude a revenue adequacy proceeding within 180 days and to determine which rail carriers are earning adequate revenues within the same 180-day period and on an annual basis thereafter.

In Ex Parte No. 393, mandated by section 205 of the Act, the Commission determined that a railroad will be considered revenue adequate if it has a rate of return equal to the current cost of capital.[10] The Commission's decision was affirmed by the United States Court of Appeals and the Supreme Court denied certiorari.

In assessing the value of a railroad's investment base for the initial determination of revenue adequacy, the Commission used the sum of the original cost of track assets, betterments to track, and the depreciated book value of all other assets. The investment base was not adjusted to reflect special tax provisions such as accelerated depreciation and investment tax credits. The cost of capital was calculated using the current cost of debt and equity for the rail industry, and a debt-equity ratio of 40:60. In Ex Parte No. 415, Railroad Cost of Capital—1981, 365 I.C.C. 734 (1982), this calculation resulted in a cost of capital of 16.5 percent based on 1981 data.

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[9] See section 10704(a)(2).

[10] *Bessemer & Lake Erie R.R. v. I.C.C.*, 691 F.2d 1104 (3d. Cir. 1982), cert. denied, 51 U.S.L.W. 3872 (U.S. June 7, 1983) (No. 82-1369).

In this proceeding, the Commission repealed earlier standards and procedures which had established a range of revenue adequacy, with the high value measured by the cost of capital and low value based on funds flow analysis. In revising the standards, the Commission pointed out that the low level calculation using funds flow analysis was never intended as a long-term level of adequate revenue. The Commission also noted that the prior standards were inappropriate in view of the Staggers Act provisions limiting rail pricing flexibility under various sections for rail carriers earning adequate revenues.[11]

Some changes have been proposed to improve the standards. In a notice served March 9, 1983, in Ex Parte No. 393 (Sub-No. 1), the Commission[12] proposed: (1) to reclassify items of income, expense, and investment to ensure that all such items, and only such items that are transportation-related, are considered; (2) to include rail affiliates in determining revenue need which would prevent finding one part of a single overall corporate system revenue inadequate while another part is adequate; (3) to use normalized data (instead of single-year data) which would tend to minimize effects of temporary fluctuations; and (4) to convert from an original cost investment base to one based on current or replacement costs, a base the Commission concludes is conceptually superior. This latter proposal follows a change in the method of accounting for track structure from betterment (original cost) to depreciation accounting. See No. 36988, Methods-Accounting For R. Track Structures, 367 I.C.C. 157, decision served February 17, 1983.

All of these proposals and changes reflect our concern in defining the revenue adequacy standard more precisely to provide a more accurate determination of the profitability of rail operations.

Ex parte No. 290 (sub-no. 2), railroad cost recovery procedures

This proceeding implemented section 203 of the Staggers Act. The section provides that the Commission shall publish a "rail cost adjustment factor" (RCAF) at least quarterly as a basis for a zone of rate freedom to compensate the railroads for cost increases due to inflation. The Commission's decision adopted as the most acceptable measure of changes in rail costs the input price index compiled by the Association of American Railroads, as supplemented by the Producer Price Index (PPI) for those costs not covered by the AAR Index, corrected and modified by the Commission as necessary. The ICC rules, based on forecasted increases in expenses, replace prior general increase procedures and authorize inflation-based increases without regulatory delay. Although railroads may increase their rates by a percentage up to including the RCAF, they are under no obligation to do so and, as a matter of record, some rates have not been increased when the opportunity has been available.

The AAR filed a proposed "all inclusive" index on January 29, 1982, which makes several changes in the methods of calculating the indices for wages, fringe benefits, fuel, materials, and supplies. It also substitutes alternative methodologies for calculating the indices in the "all other" category which are now measured by the PPI. Based on this submission, the Commission reopened Ex Parte No. 290 (Sub-No. 2) for comments on the proposed index. After consideration of the comments, the Commission issued an NPR, served June 20, 1983, proposing to adopt a modified version of the "all inclusive" index.

Various parties have contended that the AAR index, which is an input index, necessarily overstates cost increases to the extent that productivity increases occur. In an advance NPR served July 23, 1983, the Commission instituted Ex Parte No. 290 (Sub-No. 4) to seek public comment on the possible use of a productivity adjustment in determining the quarterly RCAF and methods for measuring and implementing such adjustments. The comments are now under review.

No. 38754, Arkansas Power & Light Co.—Amendment Staggers Act

In this decision served September 3, 1982, the Commission denied a petition asking that it conduct a rulemaking to implement the so-called "Long-Cannon" amendment to the Staggers Act with regard to maximum rate proceedings. The amendment lists certain factors the Commission must consider in ultimately determining whether a challenged rate is reasonable. Specifically, the Commission must consider how much of a railroad's traffic is carried at rates yielding revenues that do not contribute (or contribute only marginally) to its going concern value or fixed costs, whether the carrier has tried to minimize the amount of such traffic, and whether it has maximized revenues on its other traffic. Also, the Commission is required to examine the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

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[11] See, for example, section 203, Zone of Rate Flexibility. Section 217 of the Act also provides greater freedom in applying surcharges for carriers not earning adequate revenues.

[12] Vice Chairman Sterrett dissented in part; Commissioner Andre dissented.

Petitioners, which are pubic utilities, maintained that carrier-specific data needed to be developed in a rulemaking: (1) to enable the Commission to give appropriate consideration to the Long-Cannon factors; and (2) to determine an avoidable loss data base which would measure those losses a carrier would not be able to recoup through differential pricing.

The Commission determined that, based on the Staggers Act and its legislative history, policy reasons, and the practical difficulties of forcing railroads to undertake costly studies, a rulemaking was not required to implement these sections. Rather, the Long-Cannon factors will be considered in case-by-case adjudications.

The Commission addressed burden of proof and discovery issues with regard to use of the Long-Cannon factors in individual adjudications. The discovery issues were further amplified in No. 38025, *Dayton Power & Light Co.* v.. *Louisville & N. R. Co.*, 367 I.C.C. 365, decision served May 19, 1983. There, the Commission ruled that in complaint cases, complainants are required to make some preliminary showing of inefficient pricing by carrier defendants in their discovery requests. The scope of discovery will depend on the showing made.

Ex parte No. 387, railroad transportation contracts

As previously indicated, there has been substantial use of the contract rate provision (section 208 of the Staggers Act). Implementing rules have been issued in Ex Parte No. 387 in a decision served November 4, 1982. We have attempted to devise workable rules that will encourage the filing of contracts, without impairing the rights of protestants or unfairly injuring contracting parties by disclosing proprietary information.

To facilitate the use of contracts, and also to eliminate short-notice exemption requests, the Commission amended the recently issued rules to permit rail contracts to be implemented prior the Commission approval. (Ex Parte No. 387 (Sub-No. 200), decision served May 26, 1983). We found that our previous policy (30-day public notice before transportation under a contract may begin) is not required by section 208 (49 U.S.C. § 10713). However, the parties' rights to challenge contracts still remain intact. Accordingly, the Commission retains jurisdiction over these contracts in the 30-day period prior of formal approval (or disapproval). In the event of disapproval, the contract or tariff rate previously in effect will be fully applicable.

The Ex Parte No. 387 rules were appealed and oral argument has been held before the U.S. Court of Appeals for the Second Circuit.

Ex parte No. 388, State intrastate rail rate authority

Section 214 of the Staggers Act requires the Commission to consider certain intrastate transportation matters traditionally handled by the States. One of the new requirements was directed to the state agencies. They may continue to regulate rail rates only if they submit for ICC approval standards and procedures consistent with the standards and procedures applicable to regulation of rail carriers by the Commision under title 49, U.S.C. Upon approval of the State standards, individual state regulatory bodies are certified by the Commission to continue intrastate rail regulation subject to the specific exceptions provided in the statute (general increases, inflation-based rate increases or fuel surcharges approved by the Commission). The Act, as amended by Staggers, provides that the ICC is to assume jurisdiction of intrastate movements if a State's standards and procedures are disapproved. The Commission has also asserted jurisdiction upon request.

To date, seven States have asked the Commission to assume jurisdiction over their intrastate movements and the Commission has done so. Those States are: California, Connecticut, Delaware, Mississippi, Nevada, North Carolina, and Pennsylvania. Additionally, South Dakota specifically requested that the Commission not assume jurisdiction over its traffic; accordingly, the Commission did not assert jurisdiction. Seven States and the District of Columbia did not respond to the filing requirements and have lost jurisdiction over their intrastate rail traffic. These States are: Alaska, Arizona, Hawaii, Maine, Massachusetts, Rhode Island, and Vermont.[13]

Certification of individual states is being considered in Ex Parte No. 388, State Intrastate Rail Rate Authority—P.L. 96-448. In decisions served August 5, 1982, and January 27, 1983, the Commission certified the State of Illinois subject to certain modifications. Those decisions indicated that other States could follow the Illinois standards as somewhat of a model. States submitted further statements based on these decisions, and these are presently being reviewed with certification decisions pending.

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[13] The States that did not request certification, and those which have not refiled under our order, have lost jurisdiction to regulate inrastate rail transportation.

Under 49 U.S.C. § 11,501(c), a rail carrier may petition the Commission to review the decision of a State authority in any administrative proceeding in which the lawfulness of an intrastate rate, classification, rule, or practice is determined. The State action must be consistent with Federal law. Specific rate actions of individual states have been considered in several proceedings.[14] These cases resulted in favorable decisions for the petitioning carriers. However, in No. 38793, the Commission rejected a request for relief under section 11501(d) which gives the Commission exclusive authority to prescribe an intrastate rate under limited circumstances. The cases cited are presently subject to judicial review in various circuit courts of appeals.

Ex parte No. 445, standards for intramodal rail competition

In a petition supported by numerous shippers and several railroads, National Industrial Traffic League (NITL) sought institution of a rulemaking for the purpose of issuing rules to: (1) prohibit anticompetitive railroad cancellations of joint rates and through routes, reciprocal switching, and the closing of gateways; and (2) implement the pro-competitive provisions of the Staggers Rail Act of 1980 pertaining to reciprocal switching arrangements, and to joint use of terminal facilities, through trackage rights or otherwise.

In its decision denying the petition, the Commission concluded that rulemaking would be administratively impractical because the specific facts in each case require individual analysis and adjudication. It emphasized that each carrier should be allowed all possible freedom to structure its own pricing, service and other competitive responses, and that the Commission should intervene only where there are inadequate economic restraints on market power. With regard to recent cancellations and other restrictive carrier actions, the Commission has undertaken a study of the changes that are occurring, their reasons and effects, and will determine from the study whether further action is necessary. Comments, in conjunction with the study, may be requested at a later date.[15]

Reciprocal switching issues are being handled on a case-by-case basis. Under section 223, the Commission may require rail carriers to enter into reciprocal switching agreements when it finds that such agreements are practicable and in the public interest, or where such agreements are necessary to provide competitive rail service.

Ex parte Nos. 411 and 421, complaints filed under section 229 of the Staggers Rail Act of 1980

The rate freedom provided by the Staggers Rail Act begins with a rate level known as the "base rate." In general, the base rate is the rate in existence on October 1, 1980. However, the Act provides an exception: complaints alleging that existing rates are unreasonably high may be filed within 180 days from the effective date under section 229. During that period, which expired on March 30, 1981, 846 complaints were filed.

To organize the processing of these complaints, the Commission developed procedures for their handling which differ from those typically used. First, the railroad defendants were required to file answers and the Commission urged both sides to submit joint response. We specifically requested information with regard to whether settlement was contemplated, whether the Commission's offices would be useful in bringing about settlement, whether oral hearing, cross-examination, or other procedural tools would be necessary in particular cases, and whether certain proceedings could and should be considered. Second, we announced our intention to handle in two stages those cases that did proceed to formal adjudication. The first stage would address solely the issue of market dominance in order that time and expense would not be used because we did not have jurisdiction to review that rate. If market dominance is established, the Commission would then proceed to the second stage to take evidence and analyze the reasonableness of the challenged rate.

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[14] See e.g., No. 38793, Petition for Review of a Decision of the Public Service Commission of West Virginia Pursuant to 49 U.S.C. 11501, served Mar. 18, 1982, NO. 38809, Lousiville and Nashville Petiton to Review Decision of Kentucky Railroad Commission, served Apr. 15, 1982; No. 39060, Petition of the Denver and Rio Grande Western Railroad Co. and Salt Lake, Garfield and Western Railway Co. For Review of a Decision of the Public Service Commission of Utah Pursuant to 49 U.S.C. 11501, decision served Mar. 2, 1983; and No. 38946, Petition of Louisville & Nashville Railroad Co. For Review of a Decision of the Public Service Commission of Indiana Pursuant to 49 U.S.C 11501, decisions served November 24, 1982 and June 23, 1983.

[15] In a separate expression (concurring in part, dissenting in part), Chairman Taylor noted that Congress intended to balance the Staggers Act goals of competition and adequate revenue levels with the maintenance of an efficient, coordinated national rail system. A public proceeding would explore those goals and the tools available to the Commission to strike that balance, and would also assist the Commission's adjudication of subsequent proceedings. In his view, a staff study should supplement, not substitute for, a thorough examination of the highly important policy issues raised by NITL.

On October 29, 1981, the Commission's Chief Administrative Law Judge held a docket management conference to refine further the procedures for handling these complaints. Since that date, a continuing series of informal docket management conferences has been held, and regular docket management reports have been issued. The ninth such status report was decided on July 1, 1983, by the Chief Administrative Law Judge and is attached as Appendix IV. All cases in litigation will have procedural schedules for developing the necessary recored. Precise information concerning all pending section 229 cases is outlined in the status report.

Ex parte No. 346 (sub-No. 7) railroad exemption—export coal

By decision served June 9, 1983, the Commission[16] exempted rail export coal from regulation, effective September 12, 1983.

Export coal is sold and transported in a very competitive market where most movements are arranged by a small number of transshipper companies (rather than individual mines) which can exercise considerable leverage over the railroads. As evidence of the shipper's bargaining power, the Commission's decision points out that during a recent 5 year period mine mouth prices increased 468 percent, while export rail rates rose only 57 percent, Even after inflation adjustments, coal prices as of December 1981 were more than two and a half times greater than they were in 1969, but export rail rates increased by less than half. Between 1975 and 1981, export coal rates for the eastern carriers increased 82 percent while their overall costs rose 93 percent.

The Commission's regulation of export coal rates has long been almost nonexistent, since the world market for export coal is highly competitive and transportation pricing is restrained by product and geographic competition, as well as by competition from other transportation modes. The Commission believes that the carriers are not about to price themselves out of the market. They have large sunk costs in export coal facilities and equipment, and loss of the traffic would bring as great a hardship to the carriers as it would to the producers.

The Commission also believes it should be kept in mind that the railroads today make up the only economically regulated link in the chain of parties which handle export coal from domestic mine to foreign consumer. Given the relatively equal bargaining power of the involved parties, the Commission sees little merit in continuing to handicap the railroads' bargaining posture for the division of available economic rents from export coal. Market competition and natural forces of supply and demand should establish reasonable and rational rates for this traffic. The Commission, nonetheless, retains the power to revoke the exemption should the exemption not live up to expectations.

Ex parte No. 346 (sub-No. 8) exemption from regulation—boxcar traffic

By decision served May 2, 1983, the Commission[17] exempted boxcar movements of all commodities, except non-ferrous recyclables, from rate regulation. The exemption had been proposed by Conrail and was supported by others, including the Department of Transportation and Justice, and the Federal Trade Commission. The Commission found that the market share data and revenue/variable cost ratios of record clearly indicated that there is intense competition for boxcar traffic between the railroads and the truckers, and that rate regulation is unnecessary to protect shippers from market power abuse. The Commission expects the unregulated pricing of boxcar service to become simpler and more adaptable to changing market conditions, thus enabling the railroads to compete more effectively with the trucking industry.

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[16] Chairman Taylor dissented in this proceeding, although he has consistently supported the liberal use of the Commission's exemption authority. To the Chairman the key to this proceeding was the fact that world competition is only minimally relevant when there is almost no domestic competition, either intra- or inter-modal. Nor did the record show more than minimal product or geographic competition. As the Commission's goal is to support and encourage competition, and as competition requires relatively equal bargaining positions, to remove all regulation in this instance would also remove what leverage shippers now have and lead to an abuse of market power by railroads. Thus, because this exemption removes all ICC regulation, Chairman Taylor foresaw not only a lessening of competition, but also a distortion of the demand for services, unreasonable costs for captive products, and a serious misallocation of resources. Equally grave, he found, were the projected negative effects the exemption would have on the economic and social well-being, on the national security, and on the foreign policy.

[17] Chairman Taylor dissented from the decision on the ground that the record fails to support this broad exemption. In his dissent, he emphasized the paucity of evidence in the record and the overwhelming opposition to the proposal by the industry and virtually all the parties of record. Regarding the car hire/service portion of the decision, he expressed concern for the adverse impact this exemption might have on shortline railroads and on future investiments in boxcars. Finally, the Chairman concluded that this exemption imposed an unworkable system on an unwilling public and could endanger the nation's rail transportation system. Additionally, the decision imposed new regulations without notice.

Another aspect of the boxcar exemption proceeding involved modifications to the way in which compensation is determined for the use of boxcar equipment. The present system for compensation was arrived at several years ago during a period of severe boxcar shortage, and high rental fees were prescribed by the Commission as a regulatory incentive for equipment acquisition. These rental fees were based primarily on equipment costs rather than on supply and demand factors for equipment use. A large surplus of boxcar equipment has developed in recent years, and many owners have found that the greatest compensation can be gained by having others use their equipment. Thus, home road boxcars are now frequently routed off-line as quickly and as far as possible to gain maximum rental without regard to operational efficiencies. This system has resulted in boxcars moving empty roughly 40 percent of the time, with inefficiency costs borne primarily by the carriers located in areas where more traffic is received than is originated.

The Commission believes that the present regulatory scheme for compensation of boxcar use has long since outlived its usefulness. It stimulates unproductive equipment use in periods of overcapacity and provides compensation without regard to the realities of slackened demand. The Commission has therefore adopted a proposal to allow user railroads (1) to assess charges for empty movements made at the request of the car owner, the AAR, or the Commission (these charges may not exceed 35 cents per mile, which approximates the cost of providing the movements); (2) to store empty cars and reclaim car hire payments at the expiration of a 72-hour grace period after the car is emptied; and (3) to negotiate compensation agreements with the boxcar owners for car hire, empty movements, and storage. Other aspects of regulation, including mandatory interchange, car supply, and car hire and car service, where agreements cannot be reached, are retained by the Commission.

The Commission believes that these revisions will make car compensation more responsive to market forces by restoring supply and demand factors into the compensation equation. They should also greatly reduce the gross inefficiencies in present boxcar operations. However, the Commission intends to closely monitor the implementation of the boxcar proceeding and will not hesitate to provide further revisions should they prove necessary.

Ex parte No. 347 (sub-No. 1), coal rate guidelines

In a decision served February 24, 1983, the Commission proposed a maximum rail rate policy applicable to captive coal traffic.[18] Under the proposed "constrained market pricing" approach, rail carriers' pricing of market dominant coal traffic would be subject to four upward constraints. First, a coal shipper could not be charged more than the "stand-alone cost" of serving its traffic. Second, captive shippers would not be required to bear the cost of pricing inefficiencies. This constraint also incorporates the statutory standard of "honest, economical and efficient management." Third, carriers would generally not be permitted to increase their rates on captive traffic by more than 15 percent in a single year (after inflation). Fourth, until a rail carrier achieves revenue adequacy, it would be free to adjust its rates on captive coal traffic unless it violates one of the three other constraints.

This proposal represents the culmination of the Commission's efforts to arrive at a formula for prescribing maximum reasonable coal rates. To achieve the revenue adequacy goals of the Staggers Act, railroads should be able to assess rates high enough to recover on a system-wide basis all variable costs and constant costs, including a return on investment equal to the current cost of capital. The difficulty lies in the fact that not all rail movements can be priced at this level, mainly due to varying forms of competition. This contrasts, for example, with electric utility ratemaking, a situation in which the users generally have virtually no other option. Accordingly, to reach revenue adequacy, railroads have to price differentially some movements (in other words, allocate constant costs disproportionately).

The Commission has considered various constant cost allocation methodologies in this proceeding—ratio method, revenue additives, ton/ton-mile. Ultimately, each of these methods has been found to be somewhat arbitrary, and not based on a sound economic or regulatory basis. Accordingly, they have been rejected.

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[18] Vice Chairman Sterrett and Commissioner Andre dissented.

In this decision, the Commission proposed a modification of the theoretical framework of Ramsey pricing to allocate constant costs. Basically, the Ramsey pricing framework assigns a mark-up above marginal cost on the basis of inverse demand elasticity. Theoretically, this would yield the most economically efficient rates and the proper allocation of constant costs.

Our Modifications of the Ramsey pricing model were adoptd for practical reasons. Ramsey pricing is based on a mathematical formula which requires precise calculation of the elasticity of demand and marginal cost for every movement. The Commission concluded that, since we do not have such data and it would be difficult and extremely burdensome to develop, pure application of the Ramsey pricing model would be inappropriate. However, the Commission believes that the "market forces" theory behind Ramsey pricing is relevant and can be relied upon in conjunction with the regulatory constraints outlined above.

Comments in this proceeding are due on July 28, 1983.

Ex parte No. 403, rail carrier cargo liability study

Section 211(d) of the Staggers Act required the Interstate Commerce Commsssion to recommend to Congress within one year of enactment whether rail carriers should continue to be subject to 49 U.S.C. § 11707. That section codifies the common law governing carrier cargo liability, providing a uniform strict liability standard for railroads and other transportation companies.

The Commission's report to Congress did not recommend that rail carriers be exempted from section 11707. With respect to specific issues raised by section 211(d), the Commission recommended that the Interstate Commerce Act be amended to: (1) eliminate the venue restrictions of the Staggers' Act; (2) provide the courts with authority to award attorneys' fees to successful claimants; and (3) remove the $10,000 jurisdictional threshold for access to Federal courts. The Commission decided *not* to recommend: (1) exemption of non-market dominant traffic from section 11707; (2) imposition of a comparative negligence standard; (3) impostion of a no-fault standard; (4) changes in applicable substantive laws; (5) changes in time limits; or (6) statutory provisions governing special or consequential damages. The Commission pointed out, however, that in the absence of markert dominance, the only effect of requiring full liability rates may be the publication of excessively high rates in those cases where rail carriers choose to limit their liability through released rates.

The report was sent to Congress and made available to the public on September 30, 1981.

Ex parte No. 282 (sub-No. 5) rulemaking concerning traffic protective conditions in railroad consolidation proceedings

In a final decision in this proceeding served on March 19, 1982, the Commission found that traffic protective conditions (the so-called D, T, & I conditions) imposed in past rail consolidation proceedings were anticompetitive and contrary to the public interest, and would be revoked unless the parties demonstrate a public interest in continuing them. The decision also stated that conditions will not be imposed in the future.

This proceeding was instituted in July 1980, and was decided after consideration of the fundamental changes to rail regulation made by the Staggers Act. The Commission had imposed traffic protective conditions in an attempt to lessen the impact of consolidations on non-applicant railroads and the public and to preserve pre-existing joint rates and rate relationships. The decision pointed out the emphasis in the Staggers Act on the need for changes in rail carrier rate-setting practices, and encouraged carriers to examine existing rates and routings. The decision was appealed to the U.S. Courts of Appeals for the Sixth Circuit which stayed the effectiveness of the Commission's decision on May 19, 1982.

Ex parte No. 274 (sub-No. 8), exemption of out-of-service rail lines

A notice of proposed exemption in this proceeding was served March 24, 1982. This notice announces the Commission's intention to exempt from regulation the abandonment of rail lines which have been out-of-service for at least 2 years. In analyzing individual exemption requests, the Commission generally found that formal abandonment of a line that had been out-of-service for over 2 years would have no impact on interstate commerce or the national transportation policy or on shippers who, after two years, had typically located alternative transportation. The Commission exempted abandonment of these lines by decision served June 16, 1983.

Ex parte No. 274 (sub-No. 8A), exemption of out-of-service lines (discontinuance of service and trackage rights)

A notice of proposed exemption was served June 16, 1983, proposing to broaden the exemption of Ex Parte No. 274 (Sub-No. 8) and allow discontinuance of service and discontinuance of trackage rights without prior approval where no service has been performed over the subject line for at least 2 years.

Ex parte No. 282 (sub-No. 7), special intermodal authority

This proceeding implemented new section 11344(e) which was added by section 228 of the Staggers Act. This section permits a rail carrier or its affiliate, together with affected shippers, to file an application for motor carrier service prior or subsequent to rail transportation where rail service by other railroads is inadequate. Interim rules were adopted and proposed as final.

Few comments to the notice were received, and no applications have been filed under the interim rules. This provision may not be necessary in view of eased entry, the fact that we have exempted from regulation TOFC and COFC movements by railroad companies in Ex Parte No. 230 (Sub-No. 5), and substantial grants of authority to motor carriers substituting service for abandoned rail lines under 49 U.S.C. 10922(b)(4)(B).

Ex parte No. 282 (sub-No. 3) and (sub-No. 8), railroad consolidation procedures and railroad consolidation procedures time revisions

The proceedings revise procedural and informational requirements and the time limits for applications by rail carriers under 49 U.S.C. § 11343–11346. The revised procedures affect rail mergers, consolidations, acquisitions of control, purchases, leases, contracts to operate property of a carrier and trackage right agreements.

In September 1980, in Ex Parte No. 282 (Sub-No. 3), the Commission adopted changes to its procedural regulations that had been proposed for comment the preceding November, and published proposed informational regulations. Several months later, in Ex Parte No. 282 (Sub-No. 8), the Commission proposed (and made effective on an interim basis) changes to the time limits applicable to rail consolidation proceedings to implement section 228 of the Staggers Act.

The regulatory changes in Ex Parte No. 282 (Sub-No. 3) were developed primarily to ensure that the amount and kinds of information required in an application will vary in accordance with the significance of the transaction involved. Informational requirements have been reduced for some transactions. Other transactions subject to our jurisdiction have been deemed to have no regulatory significance and have been exempted from the Commission's regulation.

Other revisions, for the most part technical in nature, have been proposed in response to comments received from concerned parties. Such changes are aimed primarily at clarifying the regulations and streamlining various stages of these proceedings. Both decision were made final on March 4, 1982.

Ex parte No. 282 (sub-No. 6), railroad consolidation procedures, general policy statement

This proceeding is a revision of the Commission's policy statement governing rail consolidations. Between the time when the first notice was published and the final regulation was adopted, Congress enacted the Staggers Act. As a result of that action the Commission revised its notice in two ways.

First, the policy statement was limited to cases involving the merger or control of at least two Class I railroads. This was necessary because of the change in section 11344 setting different criterial for other rail consolidations.

Second, the Staggers Act added a new statutory criterion for merger involving two Class I railroads. The Commission was explicitly required to consider the effect on intramodal competition.

In general, the policy statement discusses the importance of rail consolidations in furthering national policy to rationalize the Nation's rail facilities and reduce excess capacity. It explains the statutory factors the Commission must examine, as well as the balancing test employed in determining whether the transaction is in the public interest. It also discusses Commission policy on: conditioning consolidations; inclusion of other carriers; labor protection; cumulative impacts and crossover effects; and public participtation.

Ex parte No. 282 (sub-No. 9) railroad consolidation procedures-trackage rights exemption

A notice of proposed exemption was served September 15, 1983, proposing to exempt, as a class, trackage rights proposals that are (1) based on written agreements, and (2) not sought as responsive applications in rail consolidation proceedings. Carriers taking advantage of the proposed exemption would remain subject to employee protective conditions and would not gain antitrust immunity under 49 U.S.C. § 11341. Comments are under review.

Ex parte No. 274 (sub-No. 9) abandonment of railroad lines and discontinuance of service-offers of financial assistance

A notice of proposed rulemaking was served on June 13, 1983, proposing to simplify the Commission's rules governing offers of financial assistance. Additionally, it is proposed to modify the financial assistance rules so as not to preclude the transfer within a corporate family of a line acquired under the financial assistance provisions.

Mergers

In the area of rail mergers and consolidations, the Staggers Act made two major changes: (1) Commission practice in considering competitive impacts in consolidation proceedings was codified at 49 U.S.C. § 11344(b)(5), and (2) mergers not involving two or more Class I railroad are required to be approved under 49 U.S.C. § 11344(d) unless they present irremediable competitive problems.

No merger of two or more Class I railroad have yet been governed by the Staggers Act. However in both *Norfolk Southern Corp.-Control-Norfolk, & W. Ry. Co.*, 366 I.C.C. 171 (1982), and *Union Pacific-Control-Missouri Pacific; Western Pacific*, 366 I.C.C. 459 (1982), the Commission considered the policies of the Staggers Act, especially relative to competition, in reaching its decisions. These cases were each pending upon enactment of the Staggers Act.

The new provisions governing mergers other than those involving two or more Class I railroads were applied for the first time in *Norfolk & Wester Ry. Co.-Pur.-Illinois Term R. Co.*, 363 I.C.C. 882 (1981). A Class III consolidation was exempted from the requirement of prior Commission approval in *Soo Line R. Co.-Petition for Exemption*, 366 I.C.C. 286 (1982).

TITLE III—RAILROAD COST DETERMINATIONS

This title provides for the creation of a Railroad Accounting Principles Board to establish principles for determining economically accurate railroad costs directly and indirectly associated with particular movements of goods. The Board is to establish these principles within two years of enactment of the Staggers Act. Once established, the Commission is to promulgate rules to implement and enforce them. To date, this Board has not been funded. Also, the Report of the House Committee on Appropriations on the 1982 Legislative Branch Approproations Bill, Report No. 97-170, to accompany H.R. 4120, (P.L. No. 97-51), at page 37, after recommending no funding for the Board, states that the Commission's new accounting system should be given the opportunity to achieve the necessary objective before initiating another effort which may create confusion and redundancy.

In this same general area, the Uniform Rail Costing System (URCS) is essentially complete. With the availability of four years of data (1978-1981), the Commission's Bureau of Accounts has developed cost variability equations which yield reasonable and stable results. Based on these equations, 1980 costs, cost scales, and a computerized costing program, which is available in both Digital Equipment Corporation and IBM versions, have been developed.

We believe that URCS represents a substantial improvement over Rail Form A. For example, one of the advantages of URCS is that the new regression program takes account of variations in activity among carriers both in operations and expenditures, which results in more precise unit cost calculation. Additionally, the programs and methodologies involved in the use of URCS are far more understandable than those associated with Rail Form A.

In January of 1983, the Commission proposed the formal adoption of URCS for the purpose of developing variable costs in surcharges and juridictional threshold determinations. In a decision served June 27, 1983, the scope of the inquiry was expanded, and comments were requested on the advisability of using URCS in other areas as well. The due date for comments is September 28, 1983.

The June decision also clarified certain questions which had been raised concerning the availability of the underlying data on URCS. On April 12, 1983, our Bureau of Accounts issued a memorandum announcing the availability of URCS publications, files, programs and working papers. The items detailed in the memorandum constitute all of the documentation and work papers underlying URCS. In recognition of the fact that interested persons outside of Washington may be at a disadvantage in obtaining Commission reports the Bureau of Accounts has made an arrangement with TS Infosystem, Inc. to have the documents contained in the Public Reference Room copied for interested parties at a nominal charge. The Commission also agreed that the comments could address issues other than those specifically identified in the January decision.

TITLE IV—RAILROAD MODERNIZATION ASSISTANCE

This title establishes a new feeder railroad development program which gives shippers and interested persons (other than Class I or II railroads) the opportunity to acquire a rail line carrying less than 3,000,000 gross ton-miles of traffice per mile in the preceding year if the railroad is not providing adequate service. Three years after enactment, any rail line may be acquired under this provision. The Commission may require a carrier to sell a line to a financially responsible person if the public convenience and necessity requires the sale or if the line is listed on the carrier's system diagram maps in category 1 or as potentially subject to abandonment under category 2.

The Commission implemented this provision in Ex Parte No. 395, *Feeder Railroad Development Program*. Our rules require offerors to submit evidence that they are capable of paying the constitutional minimum value of the line and of providing adequate service for 3 years. The rules are designed to encourage privately-negotiated agreements. We will set the value only if the parties fail to agree.

Recently, it has become apparent that this provision allowed affected rail carriers an opportunity to seek the dismissal of feeder notices by filing abandonment applications or amending system diagram maps before feeder applications were filed.

In Ex Parte No. 395 (Sub-No. 1), Feeder Line Development Program, we eliminated the prior notice period and established tight regulatory time frames, including a final Commission decision within 130 days of the filings of the application. These regulations require feeder and abandonment applications to be processed concurrently, giving feeder applicants an opportunity to acquire lines prior to abandonment or down grading. The final decision in Ex Parte No. 395 (Sub-No. 1) was served March 7, 1983.[19]

Title IV also established new time limits for considering abandonment applications and discontinuance of service. Applications for abandonments which are not opposed are to be granted within 45 days. For applications which are opposed, the Commission must process and decide the case within nine months. The Commission implemented this provision in Ex Parte No. 274 (Sub-No. 6), Abandonments of Rail Lines and Discontinuance of Service. The most significant changes caused by these rules are in: (1) the time frames governing the processing of abandonment and discontinuance applications; (2) the elimination of the automatic right to appeal initial decisions; and (3) the procedures for making offers of financial assistance either to subsidize continued operations or to purchase the rail line being abandoned.

Concerning appellate procedures, the final rules interpreted section 10904(c)(3) to allow an opportunity for appeal from an initial decision in an abandonment proceeding only where an investigation has been conducted. In those cases, it is a matter of Commission discretion whether an appeal will be heard. Although there is no opportunity to appeal from decisions in protested but not-investigated proceedings, the final rules allow parties to petition to reopen these proceedings after issuance of the administratively final decision. Finally, since the amended statute requires the Commission to grant all unprotested abandonments, there is no provision for administrative review of decisions in these proceedings. In the event of procedural defects (such as the loss of a protest in the mail, timely filed protests not coming to the attention of the decisional body, the failure of the applicant to afford the public the requisite notice of its proposed abandonment, etc.) the Commission will entertain petitions to vacate certificates issued in nonprotested proceedings.

In the financial assistance area, the final rules detail the procedures for filing offers. Moreover, the rules describe the mechanism which allows the parties to request the Commission to intercede and establish the conditions and amount of compensation for subsidy or purchase of the line.

TITLE V—CONRAIL TITLE V LABOR PROTECTION

This title modifies the labor protection provided to Conrail employees. The Commission was not required to implement or oversee its provisions, and thus will not comment on the title. We would note, however, that new Conrail labor protection provisions have since been enacted in the Northeast Rail Service Act of 1981.

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[19] In the Rail Safety and Service Improvement Act of 1982, Congress amended 49 U.S.C. § 10910 to make it clear that the subsequent filing of an abandonment application does not require dismissal of a feeder line notice.

TITLE VI—EXPEDITED SUPPLEMENTAL TRANSACTION PROPOSALS

This title required the Secretary of DOT, within 240 days after the effective date of the Staggers Act, to determine whether to propose a supplemental transaction for the transfer of all rail properties of Conrail in Connecticut and Rhode Island to another carrier in the region. If the Secretary had so proposed, USRA, the Commission, and the subject States were to comment on the proposal. No such proposals was submitted by the Secretary, and the section has been replaced by a provision in NERSA requiring the Secretary of Transportation to develop supplemental transaction proposals for Conrail lines in Connecticut, Rhode Island, and parts of Massachusetts. These proposals were developed and the transfers have been effectuated. The Commission was not involved in these transfers.

TITLE VII—MISCELLANEOUS PROVISIONS

The only provision of this title particularly relevant to Commission actions deals with the Alaska Railroad. The Commission was required, within six months of enactment of the Staggers Act, to complete a study to determine whether certain rail-water contract rates of the Alaska Railroad would, if such rates were entered into after enactment of the Staggers Act, have violated section 1070(c)(1) of title 49, United States Code, as amended by the Act. That section specifies that a rate cannot be considered to be below a minimum reasonable level if it contributes to going concern value; rates that equal or exceed variable cost (defined to include only those costs varying directly with the level of service), are conclusively presumed to contribute to going concern value.

The study, conducted by the Bureau of Accounts in Ex parte No. 405, *Alaska Rail Rate Study,* found the contract rates to be well above the minimum reasonable level. The study required the Commission to examine several different cost levels because of the peculiarities of the Alaska Railroad's cost center accounting system and allocation of the fiscal year 1980 Alaska Railroad capital subsidy. The minimum level was approximated by excluding capital costs and certain overhead; rates on the traffic at issue on average were 245 percent of that level and 175 percent of a "direct cost level" which would include allocable capital subsidy and would approximate Rail Form A variable costs. A subsequent study for a Congressional Appropriations Committee found the Alaska Railroad's rail-water traffic in general (of which the contract rate traffic is only a part) to be profitable, although not as profitable as the traffic considered in Ex Parte No. 405.

Summary

It is the Commission's view that the Staggers Act, and its implementation, are meeting the goals enuciated in the rail transportation policy at 49 U.S.C. § 1010a. We have every reason to believe that the Act is and will be beneficial both to the rail industry and the public over the long run. We do not believe that legislative changes are necessary or desirable at this time, particularly in view of the fact that several of our rulemaking proceedings are still being litigated. Should problems arise which require legislative action, we will, of course, notify the Congress.

Thank you for this opportunity to comment. I will be pleased to respond to any questions you may have.

[The following information was subsequently received for the record:]

QUESTIONS OF THE MAJORITY AND THE ANSWERS THERETO

Question. A number of witnesses testified that they do not believe the Commission's decisions dealing with capitive shippers actually provide protection for such shippers against unreasonable railroad rates. They cite your decisions on market dominance, revenue adequacy, and proposed coal rate guidelines. Why do you believe these decisions when taken together will constrain railroad rates?

Answer. In establishing market dominance thresholds, the Interstate Commerce Act limits regulatory intervention only to those markets where competitive forces cannot be relied upon to produce reasonable rate levels. Evidently, Congress recognized that the railroads must be free to set rates in those markets where competitive forces are sufficient to prevent abuses of monopoly power. Wherever market dominance is determined to exist, the Commission must exercise its mandate to insure that rates are reasonable. Our current thinking with respect to rate reasonableness is that maximum rates must be directly linked to the achievement of revenue adequacy. The Commission's revenue adequacy standard, established in Ex Parte No. 393, permits the railroads to earn a competitive return on their investment. This standard has been upheld by the Courts.

We believe that the "constrained market pricing" approach we have proposed in Ex Parte No. 347 (Sub-No. 1) will provide adequate protection for market dominant domestic coal shippers against unreasonable railroad rates. Under our proposal, rates on captive domestic coal traffic would be subject to four upward constraints:

"Stand-alone" cost.—The cost to any given shipper (or shipper group) is the cost of serving that shipper alone, as if it were isolated from the railroad's other customers. It represents the level at which the shipper could provide the service itself, and is the point at which cross-subsidy would begin to take place. These costs are defined as the minimum long-run average costs for the optimal capacity required by the stand-alone shippers.

Management factors.—Certain statutory factors that must be considered in the determination of rail rate reasonableness. First, the Long-Cannon provisions of the Staggers Rail Act of 1980 stipulate that the railroad, not captive shippers, must bear the burden of pricing inefficiencies. Second, where a rail carrier fails to conform to generally accepted standards of honest, economical, and efficient management, the railroad, not the captive shippers, must bear the cost of such inefficiencies.

15-percent phase-in.—The proposal generally would not permit rate increases on captive coal traffic of more than 15 percent per year, after inflation.

Revenue adequacy.—Until a rail carrier achieves revenue adequacy, it would be free to adjust its rates unless it violates one of the other three constraints. The proposed definition of revenue adequacy would be long run to accommodate yearly fluctuations.

We should emphasize that, if the rate on market dominant domestic coal traffic violates any one of the constraints, it could be found unreasonable—each factor acts as an independent restraint.

This proposal represents the culmination of the Commission's efforts to arrive at a formula for prescribing maximum reasonable domestic coal rates. To achieve the revenue adequacy goals of the Staggers Act, railroads should be able to assess rates high enough to recover on a system-wide basis all variable costs and constant costs, including a return on investment equal to the current cost of capital. The difficulty lies in the fact that not all rail movements can be priced at this level, mainly due to varying forms of competition. This contrasts, for example, with electric utility ratemaking, a situation in which the users generally have virtually no other option. Accordingly, to reach revenue adequacy, railroads have to price some movements differentially (in other words, allocate constant costs disproportionately).

Comments in this proceeding were filed in late July and are presently being carefully reviewed by the Commission.

In sum, we believe the decisions taken together will constrain rail rates in accordance with the provisions of the Staggers Act—where there is an absence of effective competition.

Question. Witnesses also indicated that in individual coal rate cases you are requiring the submission of data which is based on the proposed coal rate guidelines. Since these guidelines may change based on comments you receive, why are you asking shippers to submit this data now?

Answer. The Commission in several cases has asked the parties to submit evidence on stand-alone costs. We are aware that in pending rate cases the applications of a stand-alone cost analysis reflects a partical interim use of the Ex parte No. 347 (Sub-No. 1) methodology, which currently is merely a proposal. However, we have attempted to make it clear in each case that there are no inflexible interim rules being applied. Rather, the use of stand-alone costs is but another tool by which the Commission can evaluate the reasonableness or protested rates on a case-by-case basis.

We have requested the submission of data on stand-alone costs since it represents our most advanced thinking to date on how to evaluate the reasonableness of coal rates. As with any other case-by-case determination, we will adopt a different approach if, and when, a better methodology is developed.

Question. Some witnesses testified that the Commission has permitted railroads, like Conrail, to cancel joint rates and through routes and to close gateways without having to submit information to support such actions on economic grounds. Further, these witnesses said that the Commission has declined to investigate individual cases when it has been requested to do so. (a) What sort of information do you require railroads to submit in support of proposed cancellations and closing? (b) What sort of information do you look at in determining whether to investigate such actions? (c) What is the status of that decision remanded to the Commission dealing with Conrail's cancellation of interterritorial joint rates?

Answer. Before specifically responding to the three questions posed, some background on the relevant statutory provisions may be useful. Traditionally, a rail carrier could not establish, cancel, change or subsequently replace joint rates without the concurrence of all carriers that shared in the joint operation, absent Commission approval. 49 U.S.C. § 10762(b)(2). At that time, non-consensual cancellation of a joint rate by one or more participating carriers was possible subject to the Commission's discretionary power to suspend and/or investigate [1] to determine whether the proposed cancellation "is consistent with the public interest." 49 U.S.C. § 10705(e). Under that section, if the Commission decides to investigate, the canceling railroad has the burden of showing that the cancellation is consistent with the public interest. Section 10705(e) lists factors that the Commission shall consider as part of the public interest analysis, including a comparison of the distance and transit time of the canceled routes and alternative routes, any reduction in energy consumption, and the impact on shippers and carriers.

The Staggers Act did not change or eliminate section 10705(e), but it added a new provision, section 10705a, allowing a carrier to cancel unrenumerative joint rates (which produce revenues less than 110 percent of variable costs) without otherwise demonstrating that the cancellation is in the public interest. However, if a complaining party shows that the canceled rate in fact did produce revenues equal to or exceeding 110 percent of variable costs, the Commission nonetheless is to consider whether to allow the cancellation pursuant to the public interest factors of section 10705(e). [See 49 U.S.C. 10705a(c)(4).]

The United States Court of Appeals for the District of Columbia Circuit [2] defined the relationship between sections 10705(e) and 10705a as a "two track system."—cancellation under pre-Staggers Act law [Section 10705(e)] or cancellation under 10705a. In choosing to use the procedures of Section 10705a, a canceling carrier must comply with certain specific requirements, *i.e.* a tariff filed under this section allow a 45-day notice period. This contrasts with the ususal 10- and 20-day notice period required under section 10762(c)(3). The carrier's choice of the appropriate notice period will inform both the Commission and potential protestants whether the carrier is using the new section 10705a procedures. It should be noted that, if the carrier chooses to use section 10705, the class of eligible protestants is much more broadly defined than under the very narrow standards applicable to protests against section 10705a(c) cancellations.

Turning now to the three specific questions posed:

(a) Information in support of cancellations and closings.—Under the Act, a carrier is not required to pre-justify a proposed cancellation, and therefore is not required, initially, to submit any information in support of a proposed cancellation. If a protest is filed, the burden is on the protestants to establish the requisite elements leading to investigation or suspension. If no protest is filed, the unchallenged proposed cancellation must be allowed to go into effect, since the Commission no longer has the power to suspend on its own motion.

(b) Criteria for investigations.—The Commission has authority to investigate (but not to suspend) on its own motion. In light of the recent legislation to help resolve the continuing problem of railroad revenue adequacy, the Commission generally has allowed carriers to rationalize their rate structures in the absence of protests.

Upon protest, the Commission specifically evaluates all the evidence presented. For example, in a 10705(e) case, protestant would present sufficient evidence related to the statutory factors (comparable distance, time, effect, etc.) to place the lawfulness of the cancellation in doubt. (The burden of proof at the suspension level is considerably less than in a formal proceeding.) In Ex Parte No. 445, "Standards for Intramodal Competition," served July 7, 1983, we indicated that in the past, few protestants introduced the specific evidence required by the statute, and we offered suggestions for improvement of these presentations. Once a protest is filed, the defendant carrier responds to it specifically, offering evidence attempting to contradict protestants' claims. It is on this record that the Commission weighs all the evidence with reference to the statutory factors.

In any event, in making a determination on whether to institute an investigation, public interest considerations must be carefully considered. For example, in Ex Parte No. 445, *supra*, the Commission indicated that it will continue to be sensitive to situations where one party to a joint rate may wield an unfair advantage over another. We noted that we had suspended and set for investigation those proposals where there was the probability of unlawfulness. Moreover, even if the Commission declines to suspend or investigate, the Act provides for the filing of complaints, with the same remedies available to shippers. A number of such complaints are now pending.

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[1] The 4R Act curtailed the Commission's power to act on its own motion and stiffened the standards for suspension.

[2] Family Lines Rail System—Unilateral Cancellation of Joint Rates, 365 I.C.C. 464 (1981), aff'd sub nom., *Southern Ry. Co.* v. *I.C.C.*, 681 F. 2d 28 (D.C. Cir. 1982).

(c) Conrail joint-rate cancellation.—In "Changes in Routing Provisions—Conrail—July, 1981," 365 I.C.C. 753 (1982), the Commission found that Conrail's cancellations of certain joint rates on through routes through gateways, were shown, with one exception, to be consistent with the public interest under 49 U.S.C. § 10705(e). That decision was based largely on a study of transit time and distance, energy consumption, and efficiency submitted by Conrail.

On appeal, the court, in *Chesapeake & Ohio Ry. Co.* v. *I.C.C.*, 7th Cir., Nos. 81-2286, 82-1625, and 82-1693, set aside the Commission's decision and remanded the proceeding for further hearing on the adequacy of Conrail's study supporting the cancellations.

In a decision served August 19, 1983, the Commission reopened the proceeding for further evidence, and established a schedule for submission of evidence within 5 months of the issuance of the decision. If Conrail has not demonstrated that the involved cancellations are consistent with the public interest, the Commission will consider at that time whether to prescribe the joint rates that were canceled, or some other rates.

Question. What sort of relief is available from the Commission for water carriers that are subjected to anticompetitive behavior by the railroads? What sort of relief is available under the antitrust laws? Are water carriers required to seek relief from the Commission prior to the courts' entertaining petitions for relief under the antitrust laws?

According to the American Waterways Operators, Inc., the Commission rejected a recent petition filed by Tidewater Barge Lines challenging grain rate reductions by the Union Pacific. What relief was the barge company seeking in this case? What was the basis for your denial?

Answer. There are two basic types of anticompetition behavior. Each is discussed separately.

I. Anticompetitive behavior that could arise from rail control of water carriers

Section 11321(a)(1) states that rail carriers generally may not own, operate, control, or have an interest in a water common carrier with which it does or may compete for traffic. Section 11321(a)(2) permits a carrier to request Commission determination of competition or the possibility of competition under the subsection. Despite the general prohibition, the Commission may authorize a rail carrier to own, operate, control, or have an interest in a water carrier with which it does or may compete, if certain conditions are met, including a Commission finding that the ownership, etc. will still allow the water carrier to be operated in the public interest and will also allow competition, without reduction, on the water route in question. [11321(b)] If the Commission authorizes a rail carrier to control a water carrier, other parties may challenge the decision at the Commission, and then appeal to the courts.

All of the usual antitrust remedies are available to water carriers.

We should note that section 11344 also applies to rail control of a water carrier, whether the competitive relationship is as described above or otherwise. That section requires the Commission to approve a control application, unless it finds that the transaction is likely to result in substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation, and that the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs.

II. Anticompetitive behavior that could arise from rates and practices

Section 10703 states that rail and water common carriers shall establish through routes with each other and rates and practices applicable to those routes. Under section 10503, the Commission may require and regulate rail carrier connections between the rail lines and a dock at which an interchange is to be made, and may prescribe proportional rates, maximum proportional rates, minium proportional rates, or maximum and minimum proportional rates of a rail carrier to and from the ports served by the water common carrier. Section 10705(a)(1) states that when one of the carriers on a through route is a water carrier, the Commission shall prescribe a differential between the all-rail route and a joint rate related to the water carrier if the differential is justified, and 10705(a)(2) sets certain parameters for through routes involving rail and water carriers.

Other applicable sections include 10701(a), which requires reasonable practices, and 10701(c) which prohibits rail or water carrier discrimination in rates against a connecting line of another carrier. Section 10701a requires that rail rates not be established below a reasonable minimum.

The above sections are not often invoked by water carriers. However, section 707 of the Staggers Act states that with respect to the relationship between water and rail carriers, none of the Staggers Act amendments shall be construed to make lawful (1) any competitive practice that is unfair, destructive, predatory, or otherwise undermine competition and that was unlawful on the effective date of the Act, or (2) any other competitive practice that is unfair, destructive, predatory, or otherwise undermines competition. Section 10503 [formerly 6(11)(b)] was the basis of a Commission decision prescribing proportional rates in *Lake Carriers' Ass'n* v *New York Central R.O.*, 357 I.C.C. 159 (1977). The precise scope of Section 707 is at issue in several pending Court actions.

As a final matter, it should be noted that the protections available as to rates and practices do not apply to traffic which has been exempted from regulation by the Commission or is covered by an approved contract.

Antitrust law relief.—All of the usual antitrust remedies are available to water carriers. Aggrieved carriers do not have to seek relief from the Commission prior to the courts' entertaining petitions for relief under the antitrust laws.

Tidewater Barge Lines petition.—The Union Pacific proposed to establish, effective June 16, 1983, reduced rates on barley and wheat. Tidewater Barge Lines, Inc., protested the proposal on the grounds that the proposed rates were below a reasonable minimum in violation of section 10701a(c), and that Tidewater's ability to remain in business would be adversely affected if it reduced its rates to match UP's reductions. Tidewater requested that the Commission suspend the rate decreases pending an investigation.

Under section 10707(c)(1), the Commission may not suspend a proposed rail rate unless (among other things) it is substantially likely that the protestant will prevail on the merits. On June 14, 1983, the Commission's Suspension Board voted not to suspend or investigate. No written decision is ordinarily issued for a no-investigate, nonsuspend vote. However, the file indicates the Board concluded the evidence did not show that protestant was substantially likely to prevail on the question of whether the proposed rates were below a reasonable minimum. The Commission, Division 1, acting as an appellate Division, affirmed the Board's vote without comment on June 15, 1983. Nevertheless, Tidewater Barge Lines still has the option of filing a complaint if it wishes to pursue the matter further.

Question. The Commission apparently is prosecuting some railroads under the Elkins Act for giving discounts or rebates to shippers prior to the enactment of the Staggers Act. It also is prosecuting shippers for having received such discounts. Today, these same discounts or rebates would be lawful as a result of Staggers Act provisions allowing for contract rates or exemptions from regulation. Do you think it serves any useful purpose to seek penalties under the Elkins Act against persons for arrangements alleged to have been illegal in the past, even though they are legal now? Shouldn't the Commission examine its enforcement policies in light of (1) the new standards in the Staggers Act and (2) a need to conserve and use its limited resources to most effectively advance the public interest?

Answer. The Commission does not believe it serves a useful purpose to seek penalties under the Elkins Act against persons for arrangements alleged to have been illegal in the past if such arrangements are legal now, nor is it our enforcement policy to do so. If your question refers to a particular case, the Commission would be glad to review any matter where it is alleged this is happening.

Question. In deciding the boxcar exemption case did you consider any alternatives on boxcar rental fees that might have lessened the possible adverse effects on shortline railroad?

Answer. The Commission did not specifically consider alternatives to the current boxcar rental system in this proceeding. In a decision served June 23, 1983, the Commission stated that the defects in the per diem system will be addressed in another proceeding, Ex Parte No. 334, "Car Service Compensation—Basic Per Diem Charges." A notice of this proposed rulemaking to consider some modification in the update formula for compensation will soon be issued.

Question. Do you think the goals of this case would be seriously undermined if shortline railroads were treated separately with respect to boxcar rental fees?

Answer. This is difficult to answer without analyzing the specific treatment and its ramifications. In our boxcar decision we stated that alternatives that would avoid the potential adverse effects on small entities would substantially nullify the benefits of the exemption. We will again consider the issue to the extent raised by the parties is acting upon petitions for reconsideration in the boxcar case. In addition, this issue may be addressed in the above mentioned reopening of Ex Parte No. 334. Accordingly, a more specific answer will not be provided at this time to avoid prejudging the matter.

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS THERETO

Question. I mentioned the establishment of some type of minimum standard in my opening statement. Could you tell me if there is a concrete standard of this type being applied by the ICC today? This is to say, can you envision a case where you require a railroad to continue operating based solely on the service needs of the community (if yes, then:) Can you give me some recent examples of ICC decisions that reflect this? (if no, then:) If we were to establish such a standard, what do you believe a good "minimum level" would be?

Answer. Although I cannot envision a case where a railroad is required to continue operating solely because of the service needs of the community, such needs have been, and will continue to be, seriously examined in the performance of the balancing test. However, in light of the Congressional directive in the Staggers Rail Act to "ensure" that rail carriers earn adequate revenues, H.R. Rep. 96–1430, at 89, and the Long-Cannon amendment which requires the Commission in certain rate cases to consider carrier efforts to eliminate losing traffic and maximize revenues from marginal traffic, it would appear that the Commission cannot focus solely on the service needs of communities and ignore the burden, if any, of continued operations on the carrier and interstate commerce. Nevertheless, it is imperative that the Commission analyze the impact of each abandonment on communities and shippers before determining whether the present and future public convenience and necessity permit abandonment.

Question. Can you tell me what weight, if any, you give to such factors as grain price changes, community impact, consumer prices, etc. in abandonment proceedings?

Answer. Basically, the abandonment balancing test is made up of two parts. The first deals with the burden of continued operations on the carrier. If the carrier is unable to show it is burdened by operating losses, inadequate return on investment, or future heavy maintenance or rehabilitation expenses, it has not met its burden of proof, and abandonment will be denied. See, for example, AB–6 (Sub-No. 141), "Burlington Northern Railroad Company—Abandonment—In Henry and Mercer Counties, IL," served August 19, 1983. If the carrier makes a prima facie case, we then consider the effect upon shippers and communities. In making their case, protestants can, among other things, point out: the inadequacy of alternative transportation; the invalidity of the carrier's data, e.g., it relied on recent years with poor traffic levels, which did not reflect past operations; the future traffic possibilities; and the specific impact on each shipper and community. Only after analyzing all the evidence and arguments submitted by both the carrier and the protestants can the Commission determine whether abandonment is to be permitted. In each individual case, the weight to be given to the factors enumerated above will be dependent upon the evidence submitted.

Question. What would have to happen, even if a railroad was operating as efficiently as possible, to keep you from granting an abandonment?

Answer. If a railroad were operating as efficiently as possible and still losing money or not earning an adequate return on its investment, it is unlikely that abandonment would be denied. In fact, a better argument for denial could be made if the carrier were not operating efficiently. For example, if a carrier failed to seek new traffic, supply sufficient cars, maintain lines, etc., protestants could reasonably argue that a more efficient operation could lead to better operating results. By contrast, if the carrier does everything possible to operated efficiently, including pricing efficiently, and it still is earning insufficient revenues, one would ordinarily conclude that there is insufficient demand for its service. Under those circumstances, abandonment would normally be warranted.

Question. As you know, a 167-mile line from Pierre to Rapid City in my home state of South Dakota, is currently under consideration for abandonment. The hundreds of farmers and small shippers along that line are very worried about their future. Do you have any indication of whether or not the ICC will be able to hold field hearings on this subject?

Answer. The proposed abandonment of the Pierre to Rapid City, SD line, Docket No. AB-1 (Sub-No. 154), "Chicago and North Western Transportation Company—Abandonment—In Hughes, Stanley, Jones, Haakon, Jackson and Pennington Counties, S.D.," was set for oral hearing by decision served July 28, 1983. Hearings will be held during the week of September 19 at two locations as follows:

September 19, 1983, 9:30 a.m.; Emergency and Disaster Service; Captiol Building; 500 East Capitol; Pierre, SD 57501.

September 21, 1983, 9:30 a.m.; Legion Hall; Philip, SD 57567.

The Administrative Law Judge will issue a decision on the merits of the case by November 25, 1983.

Question. What have you done or can you do to protect rural America from future abandonment under Staggers?

Answer. Our staff is available to answer questions from concerned citizens around the country. The staff discusses not only the procedures protestants need to follow but also the type of evidence and arguments which are most likely to result in a denial of the abandonment. However, we have also tried to focus attention on the means by which shippers and communities can maintain rail service over the line if abandonment is granted. In this regard, the staff works closely with persons who are interested in making offers of financial assistance for purchase of subsidy.

Question. You may recall last year when I asked the railroads and coal slurry industry for grain freight impact figures assuming completion of coal slurry pipelines under consideration. Predictably, the railroads said grain prices would go up by 40 percent, and the coal slurries said the price would not be affected. Do you have any feel, or have you studied this to the extent that you might give me your estimations on this?

Answer. Although the Commission has not done a study on this matter, I am able to provide general observations. For several reasons, I would not anticipate a large increase in rates on other commodities if coal pipelines are constructed. First, I believe the railroads are capable of competing with pipelines for coal transportation. Second, studies of the economic impact of coal pipelines suggest that, if all the proposed lines are constructed and operate at full capacity, they would transport only a small percentage of all coal moved in the U.S.

I believe that there will be many situations where railroads provide the best combination of service and rates. However, if a pipeline can be built and provide better service and/or lower rates, it would be in the public interest to allow it to do so. There is no reason to believe that our choice is between all railroads or pipelines. I believe both modes have a role to play in our national transportation system.

QUESTIONS OF SENATOR LONG AND THE ANSWERS THERETO

Question. On page 11 of your decision in Ex Parte No. 347 (Sub-No. 1), February 24, 1983, you say:

"The 'stand-alone cost' to any given shipper (or shipper group) is the cost of serving that shipper alone, as if it were isolated from the railroad's other customers. It represents that level at which the shipper could provide the service itself."

Have you analyzed representative coal movements to determine what percentage increases from present rates would be if railroads were allowed to increase their rates to the ICC's definition of a shipper's "stand-alone cost?" If so, what are the results?

Answer. The Commission has not assessed the impact of applying stand-alone costs to specific coal movements. The primary reason for this is that a number of major issues relating to calculating and applying stand-alone costs have not been settled. We are relying on the comments to our proposal for information on how these questions should be resolved.

Question. Are these rate increases as high as the increases you believe the railroads could require captive coal shippers to pay without losing the captive shippers' business, if the railroads were totally deregulated?

Answer. As mentioned in the previous response, we have not determined specific coal rates based on stand-alone costs. Furthermore, since coal rates are currently regulated, it is not possible to determine what those rates would be if the railroads were totally deregulated. However, we can provide some general observations.

Rates under the proposed guidelines would be limited to four constraints (revenue adequacy, stand-alone costs, the Long-Cannon efficiency factors and the 15 percent phase-in) which, considered together, are anticipated to result in reasonable rates. In captive markets, the constrained market pricing approach is likely to result in rates which are below a totally deregulated level because, under total deregulation, there would be no limitations on overall earnings (revenue adequacy) or cross subsidy (stand-alone costs and Long-Cannon factors). The constrained market pricing proposal seeks to allow the railroads to earn a competitive return and prohibits cross subsidy where the evidence demonstrates a need for Commission intervention. Since the constrained market proposal is still a proposal and may be modified following consideration of comments, it is not possible to determine the relationship between those rates and rates under a totally deregulated situation.

Question. Has the ICC made any studies to determine the magnitude of railroad earnings if all captive coal rates or all captive traffic were brought to the level of stand-alone costs as the ICC defined them?

Answer. No such studies have been made. We anticipate that, under our guidelines, most railroads will attain revenue adequacy (via phase-in rate increases) before rates rise to the stand-alone level.

Question. What evidence does the ICC deem relevant in considering "the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues", as required by Long-Cannon criteria?

Answer. This issue has not yet been specifically addressed. In recent cases, the evidence has primarily focused on the other two Long-Cannon "efficiency" factors.[3] *The Dayton Power & Light Company* v. *Louisville and Nashville Railroad Company,* 366 I.C.C. 365 (1983), *Petition of Louisville and Nashville Railroad Company For Review of a Decision of the Public Service Commission of Indiana Pursuant to 49 U.S.C. 11501* (not printed) served June 23, 1983, and *Potomac Electric Power Company* v. *Consolidated Rail Corporation* (not printed) served August 1, 1983.

The Commission is implementing the Long-Cannon factors on a case-by-case basis. In *Arkansas Power & Light Co.—Amendment—Staggers Act,* 365 I.C.C. 983 (1982) the Commission set forth guidelines to govern development of evidence on these statutory factors. Relevant evidence concerning a carrier's mix of rail traffic could include an overview of revenue and cost data by commodity which indicates that a certain commodity is bearing a significantly larger amount of the fixed costs of a railroad's operation than other commodities. It should be noted, however, that relevant Long-Cannon evidence is not presumptive of unreasonableness and must be balanced with other important statutory and policy considerations—namely the revenue adequacy goal and the recognition by the Commission that differential pricing (disproportionate allocation of constant costs) is necessary to achieve that goal.

Question. Do you believe it is appropriate for a railroad to undercut barge or truck traffic rates and make up the railroad revenue shortfall on movements of captive coal?

Answer. Our policy on modal competition is that the most efficient mode should be permitted to carry the traffic. As a general rule, the carrier with the lowest long run incremental cost should have the lowest rates. There are, however, situations where short run cost considerations dictate rates. The difference between long run and short run costs is that the former includes the cost of capital assets required for service while the latter only includes operating expense.

Rates are appropriately based on short run cost considerations when there is unused capacity which could only be more fully utilized if more traffic could be attracted at a lower rate. Thus, the mere undercutting of barge and truck rates in a particular instance does not in itself suggest predatory pricing or cross-subsidization by coal movements. On the contrary, lower rates may be utilized to maximize a carrier's revenues so long as they are not less than going concern value.

Question. In your Docket 38946 decision, served June 23, 1983, involving the petition of Louisville and Nashville Railroad Company for review of a decision of the Public Service Commission of Indiana, you said that a shipper "must establish a relationship between the harm inflicted because of the [railroad's] inefficiency and the remedy (resulting rate level)" (page 10). Does this mean that even if the carrier has been shown to be inefficient, in order to get a rate reduction the shipper still has to prove that the result of the inefficiency is of such magnitude that, if cured, the "revenue inadequate" carrier would be actually earning adequate revenue? If not, what does the language mean?

Answer. No. The quoted language merely means that the remedy should not be punitive, i.e., out of proportion to the harm inflicted because of the inefficiency. The following quotation from the text of this decision (Slip Op., p. 10) provides an illustration:

"For example, if it is demonstrated that a carrier is carrying certain traffic in another part of its system at below directly variable cost and, as a consequence, is sustaining a loss on such traffic amounting to $1 million over a given period, the remedy of lowering the rate to the jurisdictional threshold based on the existence of the "inefficiency" would bear no relation to the "wrong" if so lowering the rate would deprive the carrier of $2 million over that same period. Such a remedy would be punitive and would drive the carrier farther into revenue inadequacy, in violation of the Congressional mandate."

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[3] The amount of traffic which is transported below going concern value and that which contributes only marginally to fixed costs.

In other words, an inefficiency of, for example, $1 million would not support a remedy worth $2 million. In No. 38946, the Indiana Commission never quantified the alleged inefficiency, and yet it ordered a substantial rate reduction down to the jurisdictional threshold. The state was totally unaware of whether the remedy was in proportion to the injury.

CHAIRMAN TAYLOR'S SEPARATE EXPRESSION IN RESPONSE TO THE PRECEDING QUESTION

I dissented in the L&N Case, Docket No. 38946, on the ground that the Indiana Public Service Commission, given the facts before it and the lack of Federal standards, had a rational basis to rule as it did.

QUESTIONS OF SENATOR NUNN AND THE ANSWERS THERETO

Question. Is it not the effect of the decision to transfer control over boxcars from the car owner to the car user, to thereby deprive the owner of full compensation and consequently to discourage investment in boxcars?

Answer. The effect of the decision will be to shift some of the responsibility of ownership back to the owner of the boxcar and make car compensation more responsive to the forces of the marketplace. Under the current system, the owners may profit during slack times by sending their cars onto the lines of other carriers unnecessarily in order to collect per diem charges. Owners have no incentive to minimize the car compensation and car handling costs they impose on connecting carriers.

The new system still allows owners to control their cars by requesting prompt return of the car during the three-day grace period. The empty mileage charges merely allow connecting carriers to be reimbursed, in some measure, for the costs which they incurred in handling the foreign cars.

While the effect of the decision will have some effect on the levels of net compensation received by car owners, we are confident, as stated in the decision, that it will not impair any needed boxcar investment. The decision relies on market forces to establish appropriate car compensation. In a market where supply greatly exceeds demand, some financial burdens may fall on suppliers, but we do not see this as contrary to any of the pertinent considerations under 49 U.S.C. § 10505.

A surplus of boxcars has replaced the prior shortage. In this situation, the charges for railroad use of boxcars should decline so as to encourage their use, lessen the surplus, and thereby benefit the general public by putting rail resources to work. (The reverse should take place during a shortage.) If the Commission were to attempt to maintain the value of the car owners' investment by insisting on car interchange rules and per diem level which were designed to a period of shortage, the result would only be more equipment lying idle, to the disadvantage of both car owners and shippers.

While our governing statute encourages the Commission to consider the car owners' investment costs in regulating the terms of car interchange, it does not go so far as to require us to attempt to insulate boxcar owners against business risks that are commonplace in other sectors of the economy. Moreover, as Commissioners, it is our duty to consider the effect of any changes in the car interchange system on the rail system as a whole and the general public, as well as car owners.

Question. Do you reasonably expect that a shortline railroad can effectively negotiate on equal terms a bilateral car service agreement with a major railroad?

Answer. In our view, yes, for two reasons. First, boxcar traffic faces stiff motor carrier competition. The major railroads know that a failure to negotiate equitably with the short lines could lead to disruptions in service and the loss of profitable traffic to the detriment of both the short line and the major carrier. Thus, the major carriers have an incentive to negotiate reasonably. For example, the Journal of Commerce (September 6, 1983) reported that Conrail had recently completed bilateral agreements regarding car utilization with the Delaware Otswego System—a short line network. Second, when the demand for boxcars improves, the short lines which own large fleets will possess more leverage and should be able to negotiate car hire rates higher than the prescribed levels.

We might add that our decision in Ex Parte No. 346 (Sub-No. 8) does not require the short line carriers to bargain with the major railroads. It merely allows railroads to negotiate if they are so inclined. We note that our decision retained jurisdiction in several important respects (See Slip Op., p. 28), and this retention of jurisdiction will benefit short line carriers.

Question. How do you reconcile this decision with the Lee Amendment to the Staggers Act which provides special protection for shortlines and their shippers against "unfair competition" through joint rate cancellation or surcharge (40 U.S.C. 10705a)?

Answer. The exemption order is not inconsistent with the Lee Amendment because there is nothing "unfair" about the decision. Regarding the boxcar charges, short line railroads which possess a large fleet will be in a situation similar to that of other carriers owning large fleets. They all will have to place greater reliance on forces of supply and demand for the level of compensation and return on investment.

It is not unfair to any railroad—large or small—to require it to bear the costs which its decisions impose on other railroads. Before the Commission's decision, railroads had an incentive to purchase rail cars solely to earn the per diem charges that would accrue while the cars were on the tracks of another railroad. They had this incentive even if the long-haul railroad had a surplus of its own cars and would have to incur considerable expense to return the cars empty to the shipper or railroad. In other words, these railroads were not earning their keep by engaging solely in transportation—transportation to the junction with the line haul carrier. Instead, they went into the car ownership business and attempted to make money by earning per diem on empty return haul movements. Short line railroads which are not major car owners will not be faced with this problem.

Rather than being "unfair," our decision will benefit the rail system as a whole, and ultimately shippers, by reducing the tendency of the current car interchange system to create empty movements. For example, when an origin carrier makes a decision to have the destination carrier return the boxcar empty, it should be given an incentive to weigh the benefits of this decision against the costs that the decisions will impose on the destination carrier. Only when this is done will the efficiency of the rail network as a whole be maximized, to the advantage of shippers and consumers. The empty mileage charge will provide such an incentive. If the origin carrier does not need its equipment returned quickly enough to warrant its have to compensate the destination carrier for an empty return movement, it can have the cars stored by the destination railroad until a load is available for the car.

As for the exemption itself and the possible loss of traffic due to potential joint rate cancellations, the Commission believes the extent of the predicted adverse effects has been overstated. There is no reason to expect that larger connecting carriers will cancel all joint boxcar rates. Because of the competition from motor carriers, railroads have strong incentives to make their rail service attractive to shippers, and offering joint rates is one way to do this. As long as there is a revenue contribution which exceeds costs to the connecting carriers on a particular movement, disruption of traffic should be avoided.

The Lee Amendment does not offer short lines absolute protection from any detrimental effect caused by a carrier's cancellation. The Congressional intent was to preserve the service performed by the short lines when faced with cancellations by a larger connecting carrier. The exemption decision may cause some temporary adverse results for some short line carriers. However, the Commission believes that the short line railroads are not endangered to any serious degree and that the contribution they make to the rail system will be preserved.

CHAIRMAN TAYLOR'S SEPARATE EXPRESSION IN RESPONSE TO THE PRECEDING QUESTIONS

I disagree with the majority's response to the three questions submitted by Senator Nunn with regard to the *Boxcar* case, Ex Parte No. 346 (Sub-No. 8), *Exemption from Regulation—Boxcar Traffic,* 367 I.C.C. 425.

In my view, the short line railroads do not have sufficient leverage to effectively negotiate equitable bilateral car service agreements with major railroads, nor can the decision be reconciled with the Lee Amendment [incorporated in 49 U.S.C. § 10705a as subsections (i), (j), and (k) thereof] or the clear Congressional intent to accord special treatment to short line railroads and their shippers to protect them against anti-competitive joint rate cancellations or surcharges.

In addition, the effect of the decision is, as you suggest, to transfer control over boxcars from the car owner to the car user, thus depriving the owner of compensation "determined by the expense of owning and maintaining that type of freight car, including a fair return on its cost . . ." as required by 49 U.S.C. § 11122.

These matters and the other reasons for my disagreement with the majority are set forth in my dissenting views in the *Boxcar* case, supra, which is attached hereto. I request that my dissent be incorporated as a part of my responses to Senator Nunn's question and made a part of the hearing record [4] in this matter.

QUESTIONS OF SENATOR MELCHER AND THE ANSWERS OF CHAIRMAN TAYLOR

Question. The Commission's May 2, 1983 Order dealing in part with boxcar hire compensation rules, raises many serious questions. One important question is when, in your personal opinion, do the social and economic costs of broad, abrupt deregulation actions exceed the benefits? Do the social and economic costs of the May 2 order, in your opinion, exceed the benefits?

Answer. That is a difficult question to answer in the abstract—without any given facts. As I testified at the Senate oversight hearing, philosophically, I am a deregulator. However, when deregulation occurs abruptly in a manner perceived to be irresponsible, it leads to demands for reregulation. The major purpose of the Staggers Act was to promote and insure the continuation of a healthy railroad system. This Commission has been charged by Congress with the duty of rationally deregulating the railroad industry in a manner consistent with the Rail Transportation Policy. The Commission must balance the many goals set forth in that Policy in particular cases.

In my opinion, the social and economic costs or consequences of the boxcar decision exceed the alleged benefits. The marketing problems for commodities which move via different types of rail cars, the distortion in the demand for certain types of cars, the financial jeopardy of the short line carriers, and the devaluing of property rights of the boxcar owner outweigh the theoretical benefits cited by the majority. As I pointed out in my dissent, the grant of the exemption is based upon wishful thinking and unverifiable predictions and assumptions. There is no evidence that the car hire/car service proposal will in fact save empty miles. Thus, in my view, the costs, which have been documented, clearly exceed the benefits.

Question. Does the Commission now, or did it when it acted, have any detailed information or estimates of the adverse economic consequences of the May 2 Order?

How many shortline railroads are jeopardized?

What will the impact be on shippers using Class III railroads:

Will transportation costs increase?

Will new capital costs be imposed?

Will market opportunities be restricted?

How many jobs in the short line railroads industry, in shippers' facilities, and with the owners and lessors of box cars are in jeopardy?

Answer. The Commission had projections and estimates of adverse economic consequences which would result from the decision. However, while the short lines and several shippers submitted evidence based on conditions throughout the country (unlike Conrail whose evidence was limited to the Northeast), more detailed information in the areas specified in your question would be helpful. Additional information of this nature is included in the petitions for reconsideration and such information could and should be considered on reconsideration or in a subsequent proceeding, should one be instituted. However, as presently constituted, it is highly doubtful a majority of the Commission would entertain such a proceeding.

Question. Should the Commission have had this type of information when it acted?

Answer. Yes, the Commission should have had this type of information when it acted. As I stated in my dissent, the exemption order was not supported by the record. Conrail's evidence was limited, outdated and superficial. The matter of Class II and III carriers was not addressed in an in-depth manner. As I stated in the preceding answer, I hope this will be rectified in further Commission action. The Department of Transportation, as you may be aware, has recommended a separate proceeding so that the Commission's decision can be based on a more complete record with regard to these issues.

Question. In general, which railroad interests will derive economic and market benefits from this Order if it is implemented in its present form? What percentage of the economic benefits accrue to Conrail?

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[4] See 367 ICC reports, Exemption from Regulation—Boxcar Traffic, pp. 460-467.

Answer. The terminating or using roads will derive the economic benefits because they will control whether the owning road incurs empty movement charges by deciding which cars to load and where they will go. As evidenced by the massive rail opposition to the exemption proposal, Conrail is in the unique position to gain the most from the exemption. Reflecting the particular nature of traffic in the Northeast, Conrail originates and teminates more boxcars than any other railroad. It controls one out of every six boxcar shipments in this country, and serves 2,690 stations in the Northeast. From these facts, one can infer that Conrail's percentage of economic benefits should be vastly larger than that of any other carrier. As for the market benefits, I do not think there will be any. Instead, for the reasons outlined in my dissent, I believe it will create marketing problems.

Question. What action do you as an individual believe the Commission should take in this matter to preserve the drive for common-sense deregulation without changing the rules people have in good faith relied upon in ways that impose large economic losses and create public contempt for government?

Answer. I believe the exemption order should be revoked. Conrail or any other rail carrier could then come to the Commission and ask for an exemption on a commodity-by-commodity basis. That way the Commission could analyze the individual products moving in specific markets and ascertain the probable effects of the exemption. The large economic losses you cite occur, in part, where there is abuse of market power. When exemption is proposed on a commodity basis, the product market can be defined and existing competition can be identified. This would assure that the statutory criteria of 49 U.S.C. 10505 are met. The Commission, in fact, has been actively employing its exemption authority in this manner, and the results have been beneficial and have avoided the result of a commodity being regulated when transported in one type of car but exempt in another.[5]

As an alternative to revocation, I would favor modification of the exemption order with regard to the empty mileage and storage charges. It is in these areas that the short line rail carriers, their shippers, and the boxcar owners face large economic losses due to the extraordinary leverage of terminating carriers under the decisions of the majority. This is not to say that a car utilization problem does not exist. However, I would point out that the AAR Car Management Project Task Force had agreed on a plan to alleviate the problem, but Conrail decided not to participate in view of the exemption. Thus, there are other private sector initiatives which could solve empty mileage problems. It is unfortunate that the majority did not give such initiatives a chance rather than imposing an unworkable system on an unwilling public.

Question. What options are available to the Commission in reconsidering the May 2 Order?

Answer. The options presented by petitioners include the following actions: (1) rescind the exemption; (2) delay the effective date for up to 24 months; (3) exclude the cars of Class III carriers from the exemption; (4) exclude the Alaska Railroad from the order; and (5) affirm the May 2 order with minor clarifications. Within the scope of the original proposal, the Commission would also have the option of totally exempting car compensation and car service on boxcars from regulation. In sum, any option embodying a complete or partial exemption of boxcar service from regulation would be within the scope of the proceeding and appropriate for Commission consideration.

Question. How long could this Order, in its present form, be tied up in the Courts, in your view?

Answer. If the Commission can successfully defend its decision, it would probably take somewhere from 15 months to two years from the date the court commences a briefing schedule before all appeals were exhausted. Of course, the court may remand the decision to the Commission, and we would then have to reach a new decision, which could also be appealed. Thus, this Order could possibly be tied up in court for a substantial period of time.

Question. Do Class III railroads have any realistic leverage or bargaining power in negotiating with the Class I railroads?

Answer. As I indicated at the Senate oversight hearing on the Staggers Act, I do not believe that the short line railroads have any realistic bargaining power in negotiating with Class I carriers. Besides the obvious inherent advantages which a larger carrier enjoys over a smaller one, i.e. the latter's dependence on the former for access to markets, there is another reason for the short lines' lack of bargaining power. A typical Class III carrier originates traffic in its cars but seldom has traffic in foreign cars terminating on its line. Without this source of empty foreign cars, the short line lacks leverage in negotiations with a Class I connecting carrier. There can be no agreement to exchange or "trade off" the charges owed on each other's cars as will often be the case between two Class I rail carriers.

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[5] The movement of grain, soybeans, and sunflower seeds provides an example. Just a few months ago, the Commission declined to exempt these commodities in Ex Parte No. 346 (Sub-No. 14). Now, all these commodities will be exempt when moving in boxcars, thus undoing the Commission's recent action in that proceeding.

QUESTIONS OF SENATOR MELCHER AND THE ANSWERS OF COMMISSIONER GRADISON

Question. Will the Commission make a decision on the pending Petitions for Reconsideration prior to the November 7, 1983 implementation date? Can you give us any idea as to when?

Answer. The Commission will make a decision on the petitions prior to the implementation date and, although I cannot give you an exact date, I anticipate that a decision will be made in mid-October.

Question. If the Commission doesn't act, is this matter then an appropriate subject for Congressional review and action?

Answer. The Commission will issue a decision on the petitions for reconsideration prior to the effective date of the decision. While Congressional review of any Commission decision is appropriate at any time, in this instance I do not see any need for action. I believe the decision reaches the correct result in that it promotes the objectives of the rail transportation policy by among other things allowing competition and the demand for services to establish reasonable rates for transportation by rail.

Question. Presently, two Petitions for Stay of the box car deregulation order are pending before the Commission. When can we expect a ruling on those Petitions?

Answer. I anticipate that the petitions for stay will be acted upon in our decision ruling on the petitions for reconsideration.

Question. The Commission took an additional two months after issuing a press release declaring deregulation to release a written decision. Is there any reason now why the Order must be implemented on November 7?

Answer. The written decision was issued as promptly as possibly, given the large number of issues that required discussion. The final decision served in May, 1983 provided for a six month delay in the implementation of the order until November 7, 1983. The Commission believed that since the decision affected so many shippers and commodities that a longer period was required for parties to plan and negotiate prior to the effective date of the decision. While we allowed a six month implementation period, we believe that the benefits of this exemption should be made available as soon as possible. Any further delay could be contrary to Congressional concern previously expressed as to delays experienced in implementing final rules and does not appear warranted at this time.

Question. Will the Commission take steps in the near future to clarify the ambiguities pointed out by the Association of American Railroads and the Department of Transportation?

Answer. Yes. It is our intent that the decision on the petitions for reconsideration will clarify the uncertainty expresssed by the AAR and DOT.

Question. In considering alternatives to the Commission Order which would reduce the impact of the Order upon small Class III railroad and their shippers, was the limited exemption proposed by BRHE or any similar exemption considered?

Answer. In decision, we considered various alternatives, which are identified in the answer to your question 7. We also noted that the short line railroads may have good cause to be concerned about the near term effects of the proposal. The new system required that adjustments must be made by all railroads and failure to make the adjustment could adversely effect carriers. However, in the long run there will be an appropriately sized boxcar fleet with benefits accruing to the short lines as well as others. At the time of our decision the limited exemption proposal by BRAE was not before us, and thus was not specifically considered. However, it will be considered in our decision on the petitions for reconsideration.

Question. What alternatives were considered other than the all or nothing alternatives referred to in the regulatory flexibility analysis?

Answer. Several intermediate alternatives were discussed in the Regulatory Flexibility Analysis—retaining jurisdiction over joint rate cancellations, retaining Commission review of rate changes, and disallowing the imposition of storage reclaim and empty return charges. We state that alternatives that would avoid the potential adverse effects on small entities would substantially nullify the benefits of the exemption. We concluded that such effects on small entities that may result from the exemption are not of a type, duration, or severity to warrant adoption of alternatives that would fundamentally undermine the exemption. These were the only alternatives originally presented by the parties for the Commission's consideration. However, as indicated above, the new proposals by parties to exclude some or all existing boxcars owned or leased by Class III carriers will be discussed in the Commission's decision on the petitions for reconsideration.

Question. How does the Commission justify injury to parties who justifiably relied upon existing regulations in making business and investment decisions? Doesn't their position merit relief through exception or otherwise?

Answer. It is my view that the benefits of the exemption will outweigh any possible harm. The parties may negotiate bilateral agreements as to the level of compensation for car hire, empty movements and storage. Boxcar owners, large and small, may experience a decrease in net revenues as a consequence of storage reclaim and empty return charges. This effect, however, is likely to be limited to periods of slack demand for boxcars. When demand is strong competition for scarce equipment should lead to negotiated car hire, rates higher than prescribed levels, thus offsetting to some degree the adverse effects on carowners during slack periods.

Furthermore, defects in the present regulation, in particular car hire have been the subject of increasing scrutiny in recent years. Pronouncements by both the Commission and Congress have amply indicated that major changes were in the offering, and any investor should have been forewarned as to the risk involved. For example, the Commission instituted a rulemaking to consider the elimination of the incentive element in the car hire rate and after public comment eliminated incentive per diem charges in Ex Parte No. 252 (Sub-No. 5), "Elimination of Incentive Per Diem Charges," 364 I.C.C. 116 (1980). Concurrent with Commission action, the Congress was aware of the problem of incentive per diem and in section 224(a)(1) of the Staggers Act of 1980 formally removed future Commission consideration of an incentive per diem element in setting car hire charges. Congress was aware of the problems of the existing car hire system and that any movement away from incentive per diem or the current system could potentially harm existing third party investors. It is undesirable for increased financial burdens to fall on various outside parties, but this is subordinate to the Commission's broader responsibilities to railroads and shippers under our exemption authority. Finally, given the oversupply of boxcars and the low level of new investment, to make exemptions for all existing cars would nullify the intended beneficial effect of the exemption.

Senator **Danforth**. Thomas Till, Deputy Administrator, FRA. Mr. Till.

STATEMENT OF THOMAS A. TILL, DEPUTY ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION, ACCOMPANIED BY J. CHRISTOPHER ROONEY, ASSOCIATE ADMINISTRATOR FOR POLICY

Mr. **Till**. Good morning, Mr. Chairman.

With me today is J. Christopher Rooney, the Associate Administrator for Policy of the Federal Railroad Administration.

With your permission, I would like to have my complete statement inserted in the record and at this point make a brief summary.

Senator **Danforth**. You do not even have to ask for permission, Mr. Till. That is automatic. If you could summarize it in a short time, it would be appreciated.

Mr. **Till**. The generally healthy financial state of the railroad industry given this time of recession that we are in has been noted. The Department believes that the Staggers Act is the most important factor in contributing to that relatively good health.

In general, the Staggers Act has increased shippers' transportation options, and many railroads have reduced rates or offered new services to meet competition, to balance traffic flows, and to hold their increased market share. Contract rates are increasing in popularity, and new joint rail-barge movements of export grain are developing. On the average, rail rates have not increased as much as rail costs.

Let me now address a number of specific topics.

Bulk commodity transportation: FRA research on the effects of the act has concentrated on bulk commodities. Our studies indicate that no major utility company is solely dependent on rail transportation for its fuel supply. The staff analysis and research performed at Texas A&M and at Iowa State University showed that competition from trucks, barges, and other railroads is a significant factor restraining rail rates on export grain.

Revenue adequacy and nonrail acquisitions: Although there is still a large gap between the ICC's adequate rate of return level and the actual rate of return of the industry, the Staggers Act has allowed the railroads to weather the recession. Recent nonrail acquisitions by railroad holding companies must be evaluated in light of the fact that many railroads and their parent firms earn a considerable portion of the revenues from nonrailroad activities.

Joint rates and through routes for interline movements: A railroad should be allowed to set rates independently for its own portion of a movement, as long as such actions do not detract from a competitive, efficient transportation system. While railroads have been aggressive in changing their rate structures to eliminate costly and inefficient routes, they can be expected to maintain mutually advantageous joint rates.

Export coal: The Department believes that the presence of ample competition justifies the exemption of rail export coal traffic. Large coal producers and brokers represent a substantial share of the export market and ship coal from mines on more than one railroad.

Boxcar deregulation: The Department also supports the ICC's exemption of rail boxcar traffic and the modification to the car service rules which are designed to reduce empty car miles and encourage the storage of unneeded equipment.

There may be a need for further examination of the impact of exemption or short-line railroads whose equipment is used primarily by their own shippers.

Coal rate guidelines: The Department generally supports the ICC's proposal to use stand-alone costs in determining rates on market-dominant coal traffic, and we are reviewing the way in which the standards will be developed and applied.

Mr. Chairman, in concluding this summary I would like to say that we have been in an essentially substantially deregulated railroad environment for about 2 years at this point. If we look to our neighbors to the north, we find that the experience in Canada after they had deregulated their railroads in 1967 was that it took approximately 6 to 8 years before the railroad transportation system was able to adjust completely and effectively to a deregulated environment.

I think that we in this country, our railroad industry, the shippers who depend on railroads, have made much more rapid progress than that, and indeed we need to, because the state of our transportation system, the state of our railroad industry I think was much graver than was the case in Canada in 1967.

The Department believes very strongly that railroad deregulation is an absolutely and utterly essential item for the continued improvement in the financial health and the transportation effectiveness of the railroad industry. And at this point we believe that we would like to continue to have the railroads have the opportunity to adjust to the Staggers Act and without any major or any substantial modifications of a legislative nature.

That concludes my statement, Mr. Chairman.

Senator DANFORTH. Thank you very much.

Senator Gorton.

Senator GORTON. Does the administration and the department support reconsideration of the May 2 order of the Commission on boxcars?

Mr. TILL. The position that we have indicated, Senator, is that we feel that it may be appropriate for the Commission to in a separate proceeding examine the effect of the boxcar deregulation rules that they have developed on short line railroads whose cars are owned—are used primarily for the shipment of materials on that railroad.

Senator GORTON. Does that mean a separate proceeding while the order is in effect? Or during a continuation of the status quo?

Mr. TILL. I think the idea would be to try to conclude that proceeding prior to the time that the rule would go into effect. But we are looking at a situation where we are talking about short line cars loaded regularly or exclusively by the short line shippers involved. I think that is a fairly narrow case.

Senator GORTON. Thank you very much.

Senator DANFORTH. Senator Exon.

Senator EXON. Thank you, Mr. Chairman. Just one question, Mr. Till. I do not know as much as I should about the railroad deregulation in Canada. Could you enlighten me as to whether or not during the intervening 6-year period when you said it was deregulated and then the railroads were able to adjust, there have been similar problems to what we are experiencing now. Is it not true that the railroad industry in Canada is subsidized directly or indirectly, and that Canada's deregulation is unlike ours? How did they address the matter of captive shippers during that intervening 6-year period?

Mr. TILL. I think it is not quite fair to compare the Canadian railroad industry with the U.S. railroad industry in terms of complexity. They run very similar operations in terms of being large railroads that carry a lot of bulk commodities and are an important part to that extent in that manner of the transportation infrastructure of the country. But I think the complexity of our system is much greater. We have many more interline movements among two or more railroads. There is an element or there has been an element of subsidy involved in the Canadian system. They have two major railroads, the Canadian Pacific and the Canadian National. The Canadian National is a nationally owned railroad, and they do or they can use funds from the Canadian national Government as part of their operating revenues or for capital investment.

But I think that they have been run, and quite successfully in recent years, on a profitmaking basis. So I think that there is a good degree of comparability. To the extent that they have fewer problems of the sort that we are having, I think it is the result of the fact that their industry is not so complex, and quite frankly, my opinion is that we are doing remarkably well, given the complexity of the railroad system and its role in the transportation system of the country, and second, I think, given the fact that railroads have not been used to make commercial arrangements for the large bulk of their commercial dealings in the past. They are learning, and the shippers that they serve are learning with them, and I think all in all that progress is going very well.

Senator EXON. Thank you, Mr. Till. You made the point that I wanted made. When you mentioned our rail system and the similarities in overcoming problems, indicating that maybe all would be well after 6 years, I thought it was somewhat of an oversimplification. I am not sure that we should diminish the opposition that some of us have to the way this has worked out thus far by just assuming that in another 4 years all is going to be well because I suspect that that might not be the case.

That is why I was somewhat puzzled with your reference to the Canadian railroads. The statement you just gave me leads me to believe that I was probably correct that there may not be a great deal of similarity between their system and ours for the reasons you cited.

Mr. TILL. One major point of similarity that I did not—a comparison I did not draw but I think is very relevant is that the financial condition of the railroad industry in Canada, the two major railroads, and they are large railroads, comparable to large American railroads, the financial condition was such that the Canadian Government saw fit to deregulate largely their commercial dealings. I think a good comparison in this country is that it became obvious after the creation of Conrail and the fact that it was not performing up to snuff in terms of the financial projections, that more had to be done, and what has been done in recent years is to deregulate the railroad industry and Conrail along with it. So just as Canadian National was able to eliminate its deficits and begin to run effectively and profitably, so Conrail and the rest of the railroad industry have been able to thrive under a deregulated environment.

Senator EXON. But is it not true, Mr. Till, and correct me if I am wrong, that the very important area of grain movements is subsidized very heavily by the Canadian Government as part of its overall domestic and international marketing of grain? Are there not direct Government subsidies—the Government paying for a substantial portion of the grain that is moved about Canada from inland to the ports?

Mr. TILL. They do have in place what are called the Crow's Nest pass grain rates, which effectively were not deregulated as part of the 1967 act.

Senator EXON. Thank you.

Senator DANFORTH. Mr. Till, could you give me your views on the ICC's definition of effective competition and its inclusion of geographic and product factors in determining what is effective competition?

Mr. TILL. Yes, Mr. Chairman. We do believe that those are appropriate components in a definition of effective competition. Our feeling is that—I believe I listened to your analogy earlier about when beef is too expensive, people will eat chicken. That may not make the beef producers very happy in the short term, but in the longer term, it may have a lot to do with how people go about improving the efficiency of their industry.

I think that that particular—those particular factors are most often used in looking at captive shippers and bulk commodities. In the case of coal, we have to look not only at the transportation costs involved, but also at the production costs, because as we compete, as coal from one region competes against coal from another region for the domestic market in this country, or as we have similar interregional competition for the export market, you are looking at a whole set of costs that do not involve just railroad costs, but also costs of production and ocean transportation costs.

Senator DANFORTH. Let us take the shipment of grain. The geographic and product tests would apply to the shipment of grain as well as coal, would they not?

Mr. TILL. Yes, they would.

Senator DANFORTH. All right. Now, let us just take a hypothetical part of the country which is served by a railroad, and there is no other mode of transportation in this hypothetical part of the country. Trucks do not go there. No barges go there. Just the railroad.

Now, is it a fair measure of effective competition to say that consumers of grain are able to go to, say, some other State or some other part of the country or use some other kind of foodstuff in place of the grain that is being shipped to this part of the country, and therefore there is effective competition?

Mr. TILL. I would say that, first of all, I would change your hypothetical in one regard, and that is that trucks do not go there. Studies have indicated that there is——

Senator DANFORTH. I am just working on a hypothetical here. Could you give me your answer? It seems to me that if the railroads went through the roof, the trucks would chase them behind, would chase them pretty quickly, even if you had trucks there. But that would be intermodal competition. That would be a different part of the equation which would be measured. I just want to work on these two factors, geographic and product competition. Is it relevant to say that we do not really care about the grain producers of, say, Nebraska, because we have bumper crops, and we have had for a couple of years, and we do not need them any more?

Mr. TILL. I do not think that any enlightened firm is going to take that attitude toward its customers. If they take that attitude in the short run, they can hurt themselves in the long run, and I think that in their business dealings, a railroad is simply not going to take that kind of an approach.

Senator DANFORTH. I think that is wishful thinking, really, to just hope for the best. The question is, as I understand it, under what circumstances will the ICC regulate on the basis that there is not effective competition. In this hypothetical situation, you would say that it would not regulate and it should not regulate because people can eat anything.

Mr. TILL. I do not think that is the situation, Senator.

Senator DANFORTH. Why is that not the situation? Let us suppose hypothetically, again, just to renew my hypothetical, say the State of Nebraska is served by a railroad and it has no other means of transportation, and there is plenty of food around, and we have had a couple of bumper crop years, and there is food available from Kansas and Missouri and so forth. Is that to say, well, we have competition in food, and therefore who cares about competition in transportation? Is that reasonable? I mean, I thought that the ICC was in the business of determining when and under what circumstance it should regulate competition, not to view the total situation with respect to, say, nutrition and the availability of food throughout the country.

Mr. TILL. That is correct, but I think that under the act, if the shipper is indeed found to be a captive shipper, then the Staggers Act provisions will apply.

Senator DANFORTH. Well, is that not what we are talking about, or do I misunderstand the law? I understand that the question is whether or not the ICC will regulate because of lack of effective competition. The ICC says in determining competition it will determine not only competition in transportation but also competition in the underlying product.

Mr. TILL. I think that I would hope that in any situation that went as far as the situation you are describing, Senator, that the Interstate Commerce Commission would find that there is market dominance, and there is a de facto captive shipper.

Senator DANFORTH. Senator Long.

Senator LONG. No questions. Thank you.

Senator DANFORTH. Senator Kassebaum.

Senator KASSEBAUM. Mr. Till, I did not get a chance to explore this with the other panel, and I regret coming in late, but let me just explore with you a minute and see what your interpretation might be. In the case of grain rates, as it is stipulated under the Staggers Act, the ICC contracts are posted, and the ICC has responsibility for assuring that the essential terms of the contract are available to the general public in tariff format.

Now, under the guidelines of the ICC, however, the requirement is that the name of the railroad, the commodity, and the length of the haul are required to be made public. There are a number of elevators and shippers who are very concerned that actually this is certainly not enough information to make it competitive, and I wonder if—I wonder how you interpret this, and if you see this in any way as thwarting or being determined as perhaps unreasonable discrimination. Are you familiar enough with that aspect of the Staggers Act?

Mr. TILL. With your permission, Senator, I would like Mr. Rooney to answer that.

Senator KASSEBAUM. OK. It may be something that is unfair to ask you, but it is an important interpretation, I think, regarding contracts.

Mr. ROONEY. Well, Senator Kassebaum, I am sure you are aware that the Commission has debated quite frequently the proposition of how much information ought rightfully to be disclosed in these contracts. I think in the instance with respect to certain agricultural commodities there is an obligation of greater disclosure, but let me go further and add on the basis of a general proposition that the railroads are engaging in a tailoring of rates to meet various service, equipment, scheduling, and other kinds of requirements of their shippers.

To some degree, there is a fear here that overdisclosure could result in damage by virtue of release of proprietary shipper information, and not just the other side of the coin, which would be release of otherwise publicly published tariff information, so there is a two-way street.

Senator KASSEBAUM. Well, I personally think that it could only, one, provide true competition, and I see no reason why really rates should not be posted as they were prior to the Staggers Act.

Mr. ROONEY. Again I reiterate the agricultural provisions and——

Senator KASSEBAUM. There are different, of course, shipping modes and so forth that have to be taken into consideration, but that is part of the posting as well.

Mr. ROONEY. Yes. Now, the other point that comes to mind is to point out that the rails are the only ones in the transportation mix at the present time who would have to so post rates. Truckers generally have been free from regulation with respect to agricultural commodities for a great long time, as have the barge men. They do represent a unique kind of situation in terms of having to disclose rates.

Senator KASSEBAUM. So you do not really feel that this is a problem?

Mr. ROONEY. I would hesitate to be so general as to say that without letting the Commission complete its occasional deliberations on how much information ought to be presented. We have not considered that particular issue in the fashion which would allow us to reach a conclusion.

Senator KASSEBAUM. Thank you.

Mr. TILL. Senator, if I might just add one point to that, I think that part of what we are going through in this whole adjustment to deregulation is that people are learning how to deal in a changed environment, and because the shippers have not had to do this with regard to railroads in the past, they have to learn how to do it just as railroads have to learn how to negotiate with their grain shippers, with their coal miners, and I think we are going through a learning process in which things are shaking out, and I think we are going to find that when we go through this, people are going to work out satisfactory arrangements. Shippers and railroads are going to be able to negotiate and come to terms, and that is why we find this tremendous growth in the number of railroad contracts, over 8,000 as of June of this year.

Senator KASSEBAUM. I agree with that, but part of negotiation, it seems to me, should be adequate information that is available, and you really cannot enter into any bids in, I think, a fair participation in the marketplace if you do not know what your competition is really all about.

Mr. TILL. I think there are available a number of commercial services which are not particularly expensive which can enlighten shippers as to what the costs of their transportation alternatives are, and can help them a great deal. The marketplace is working in that respect. It can help them in negotiation. I used to work for a firm that provided those kinds of services, and there are a lot of them around, and they can be very useful to shippers in negotiating contracts for transportation.

Senator KASSEBAUM. Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF THOMAS A. TILL, DEPUTY ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION

Mr. Chairman and members of the Subcommittee, I am pleased to be here today to talk about the Staggers Rail Act of 1980. Before I comment on the specific issues you have asked me to discuss, I would like to present our general views of the effects of the Act, and of the progress toward meeting the goals of the legislation.

The principal purpose of the Staggers Act was to reduce or eliminate the burden on commerce imposed by regulation and to permit competitive forces to work wherever possible for the benefit of railroads and shippers. Combined with the subsequent actions by the ICC to implement the legislation, the Staggers Act has allowed railroads to respond to shippers' needs and market conditions by adjusting rates and tailoring services to attract and retain traffic. Shippers' transportation options have increased, and may railroads have reduced rates or offered new types of service to meet competition, balance traffic flows, and hold or boost market share.

Railroads and shippers have been particularly active in negotiating rate and service contracts, which were explicitly authorized by the Staggers Act. As of June 30, 1982, 1,400 contracts had been filed with the ICC; now, one year later, there are over 8,000 contracts on file. The contracts cover almost all commodities handled by railroads. They offer volume incentives, guaranteed car supply or other special services, with terms lasting from less than one month up to 15 or more years.

In those commodity areas already exempt from regulation, the railroads have moved aggressively to build traffic. Railroads' piggyback business, the major service exempted since the Staggers Act was passed, has grown to record levels. Despite a reduction in overall rail traffic between 1981 and 1982, piggyback carloadings rose significantly.

Prior to 1980, rail/barge transportation of export grain was almost non-existent. Provisions in the Staggers Act increasing rate flexibility and encouraging independent ratemaking have contributed to the introduction of new single-line rates for trainloads of export grain to river ports, for barge movement to the Gulf. The new combinations of low rail and barge rates have made these intermodal shipments a more attractive option for many shippers.

In most markets, railroads have had to increase their rates to reflect increases in the prices railroads pay for fuel, materials, and labor. Since passage of the Act, the Association of American Railroad's Index of Materials, Wage Rates and Supplements has gone up 21 percent, while overall rail rates, as estimated by the Bureau of Labor Statistics, have increased only 19 percent.

In monitoring the effects of the Staggers Act, we have paid particular attention to bulk commodities. In the years since the legislation was passed, rail tariff rates for unit train coal movements in the West have gone up more quickly than in the East and more quickly than rail rates in general. However, the calculations do not include rates set in long-term contracts negotiated between shippers and railroads. Our research also indicates that no major utility is solely dependent on rail transportation for its fuel supply. A review of 50 major U.S. utility companies shows that only 5 appear to rely on rail-carried coal for more than 75 percent of their generating capacity.

For export grain, while it is likely that rates for all modes will increase as traffic levels rise, studies by FRA, Texas A&M and Iowa State Universities indicate that competition from trucks and barges, as well as from other railroads, will restrain rail pricing. Analysis of export corn movements from the Midwest indicates that only a 10 percent rail increase would result in a 40 percent loss of rail export grain traffic, if the rates of other modes are held constant. Of the three major markets for corn originating in the study areas—export, domestic interstate and intrastate—railroads were the dominant mode only in the interstate market—a market that accounts for only 18 percent of all the commercial corn shipments by any mode.

The economy has been extremely weak in the years since passage of the Staggers Act, and railroads have not been immune to the effects of the recession. I believe the Act was a major factor in the railroads' ability to weather the storm. While their earnings are still not sufficient by standard investment criteria, there have been no business failures such as those that occurred in the last decade. Notwithstanding these encouraging signs, there is still a large gap between the 3.98 percent return earned by the railroad industry in 1981—down slightly from 1980's record level of 4.13 percent—and the 16.5 percent established by the ICC as an adequate rate of return.

I know there is some concern that railroads judged by the ICC to have inadequate revenues are now involved in acquisitions of large non-railroad entities. In evaluating these acquisitions, several points are worth noting. First, many railroads are subsidiaries of parent corporations or holding companies which earn a considerable portion of their profits from non-railroad activities. The investment decisions of a parent corporation must be considered in light of all its diversified activities and interests, not just the railroad. The ICC's revenue adequacy determinations relate only to the railroads, for which separate accounting is made. From just the railroads' ICC accounts, one sees that 1982 income from other sources other than railroad operations, such as land development or lumbering, constituted 60 percent of all operating income before considering fixed charges and taxes.

Since the Staggers Act, some railroads have cancelled a large number of joint rates and reciprocal switching agreements with other carriers. The ICC has approved most of these, based not only on the Staggers Act, but also on a reinterpretation of other joint rate provisions of the Interstate Commerce Act. Shippers have expressed concern that the loss of an equalized rate structure means they have fewer routing choices.

We believe a railroad should be allowed to set rates independently for its own portion of a movement, as long as such actions do not detract from a competitive, efficient transportation system. Historically, some railroads did not receive revenue divisions sufficient to recover their portion of the costs of joint line rail movements, and cumbersome regulation of joint rate divisions prevented them from rectifying such situations. In many cases, the same joint rate applied over a variety of rail routings between two points, regardless of the cost associated with any route. This rate structure did not encourage the use of the most efficient routes, by the shipper or the railroad. Certainly, some railroads have been aggressive in changing their structure. But, the industry can be expected to maintain mutually advantageous joint rates.

Another of the Staggers Act changes which has had a major impact on the rail industry and its shippers is the expansion of the ICC's power to exempt traffic from regulation entirely if regulation is not necessary to protect shippers or carry out the national transportation policy, or if the traffic is of limited scope. Although piggyback traffic is the only major commodity group to be exempted since the Staggers Act, the Commission has recently announced two additional exemption decisions, to be effective later this year. Export coal moved by rail to U.S. ports is to be exempt in September, and rates on railroad boxcar traffic will be deregulated in November.

The Department of Transportation supports the exemption of export coal, and has filed extensive comments in the proceeding. We believe that there is ample competition in the export coal market: the fact that a single mine is served by a single railroad does not give that railroad absolute market power over the movement of coal. Most companies participating in the export market are large coal producers or brokers that represent a substantial volume of traffic for the railroads and can market coal from mines on more than one carrier. For example, the ICC noted in its decision that the 8 largest producers and brokers accounted for 66 percent of coal exports handled by the Chessie System and 83 percent of the exports handled by the Norfolk and Western in 1981. Moreover, competition for overseas coal business in the world market is intense, and the railroads could suffer the loss of their export traffic if the total delivered price of U.S. coal is to high. With weak world demand in the past year, we have seen this hypothesis borne out. Several railroads have recently offered attractive contract terms or reductions in tariff rates for export coal, in response to market circumstances and shippers' needs. In addition, railroads have not taken any of the increases above inflation which the Staggers Act allows, nor did they apply the most recent inflation-based increase to export coal traffic.

The Department also supports the ICC's decision to exempt all rates on boxcar traffic, and to modify the care service regulations governing that equipment to deal with the problem of costly empty mileage. An originating railroad currently attempts to supply its own cars to load a shipper's traffic, in order to earn rental fees (per diem) on the cars when they are sent off-line to another railroad. On the other hand, a railroad quickly sends foreign equipment back empty, to minimize it per diem payments to the owning carrier. These actions are not efficient at any time, but they are especially inefficient during times of considerable car surplus such as we are experiencing at present. The changes to be allowed under the Commission's order are intended to encourage the storage of unneeded equipment and reduce the industry's empty mileage costs at the same time that freight rates may be freely set to increase the use of boxcars.

Many non-railroad boxcar owners have objected to the ICC decision because they believe that changing the car service rules to allow the imposition of storage and empty return charges will deny them a fair return on their investment. But, with current traffic levels and excess car capacity, all car owners are realizing a lower return on their equipment. The ICC should not tailor its decision to protect firms from legitimate business risks. However, the Department has suggested to the ICC that there may be need to consider the impact of the exemption on shortline railroads whose cars are used primarily or exclusively by their own shippers. Such carriers have claimed that they do not have sufficient bargaining power in dealing with larger railroads. We have suggested that the Commission should consider this issue in a separate proceeding.

The Commission has also proposed domestic coal rate guidelines for traffic over which a railroad has market dominance. These guidelines would be based on the principle that no shipper should pay more than stand-alone costs. Comments in this proceeding are due on July 28, and the Department will submit a formal filing at that time. We generally support the ICC's proposal, provided that implementation is based on thoroughly researched and carefully deliberated techniques for its application.

That concludes my testimony. I would be happy to answer any questions.

[The following information was subsequently received for the record:]

Questions of Senator Pressler and the Answers Thereto

Question. You will recall my question of last year regarding the price impact on grain transportation by rail assuming the completion of planned coal slurry systems. Could you give me a little background used in the methodology used in arriving at the 40 percent figure, and why is this so different from the coal slurry industry's answer of 0 change?

Answer. The 40 percent figure referred to the impact on a specific rail segment (the Miles City line) which carried both coal and grain traffic. Total costs for operating that line were determined, and the variable cost of the coal traffic (the cost not incurred if the traffic did not move) was subtracted from the total figure. When revenues generated by the coal traffic were subtracted from total revenues generated by the line, it was determined that rates on the rest of the line's traffic, primarily grain, would have to rise by about 40 percent to cover the remaining unavoidable operating costs.

Question. Do you agree that rail service in rural America has declined since Staggers deregulation?

(If yes, then:) What can be done about it? Must we just live with it?

(If no, then:) What do you base your anwer on?

Answer. We have no reason to believe that rail service to rural areas has declined as a result of the Staggers Act. The Department of Agriculture's 1982 study of the effects of both the Staggers and Motor Carrier Acts concluded that most shippers, including small elevators, benefitted from the lowered rates and increased competition resulting from the railroads' attempt to retain grain traffic in the face of depressed shipment levels. A recently released General Accounting Office study, "Information on Regulatory Reform Under the Staggers Rail Act of 1980", while not specifically concerned with service to rural areas, found that rates for most commodities have increased less rapidly since the Act than in the years prior to the legislation, and that at least half of the shippers surveyed felt service had improved since 1980.

Another indication of service levels in rural areas is miles of track abandoned. Although the Act did not change the criteria for granting abandonments, it did impose strict time limits on ICC deliberations. Despite this change—and excluding Conrail abandonments, which were handled under special provisions of the Northeast Rail Services Act—abandonments in the 32-month period since the Act was passed have amounted to only 5,045 miles as compared to 6,754 miles in the 36 months prior to enactment.

QUESTIONS OF SENATOR MELCHER AND THE ANSWERS THERETO

Question. In responding to the petitions for reconsideration filed by BRAE, the Railway Progress Institute and others, the Department of Transportation indicated that the Commission's record was inadequate on the impact of the new car hire rules on shortline railroads. In light of the numerous shortlines that have filed statements supporting reconsideration does the DOT believe that the record is now sufficient for the Commission to proceed?

In light of the replies filed by shortlines, does the DOT have any position on whether the new rules should be applied to shortline railroads and their box cars?

If the Commission were to accept DOT's suggestion of opening a separate rulemaking proceeding to deal with box cars owned or leased by Class III railroads, is it your opinion that this would delay implementation of the other aspects of the Commission's Order?

Answer. The Interstate Commerce Commission is the proper judge as to whether the record on this question now justifies a further proceeding; we do not believe a proceeding, if held, should delay implementation of the decision. If the ICC does decide to open an inquiry on this limited issue, DOT will participate. Based on our initital review of the comments filed in response to the BRAE petition, we continue to believe that the exemption must apply to all railroad-owned cars if the costly inefficiencies inherent in the current system are to be eliminated. Shippers who make exclusive use of shortline-owned boxcars may wish to consider purchasing (or leasing) that equipment, since shipper-owned or leased cars are not covered by the exemption.

Question. How should the Commission resolve the ambiguities in the rules such as those that the DOT referred to in its letter to the Commission responding to the Reconsideration Petition?

The DOT June 20 letter to the Commission suggests that the Commission's ruling should be more specific about certain operational ambiguities arising out of the May 2 Order. Do you believe that the Commission should stay implementation of the Order until these ambiguities are cleared up?

Answer. Under the decision in Ex Parte 346, Sub. No. 8, the ICC retains ultimate authority for all car service rules for boxcars. However, the rail industry, through the Association of American Railroads, will continue to issue and enforce service rules for these cars, as it does for all rail equipment except trailers and containers in TOFC/COFC service. The O-T (operations and transportation) General Committee of the AAR, on which the Americna Short Line Railroad Association is represented, is in the process of drawing up new car service rules for boxcars to implement the ICC's decision and clarify any remaining ambiguities. These rules should be finalized by November 7, the day the exemption becomes effective.

Question. Is it your belief that both the questions raised by the BRAE Petition and the ambiguities stated in the June 20 letter warrant the institution of additional rulemaking with respect to the Commission's new car hire regulations?

Answer. See answers to above questions.

Question. Supporters of this boxcar order have compared it to the Trailer on Flat Car/Container on Flat Car (TOFC/COFC) deregulation order of 1981. Do you believe that the transition to the new Commission regulatory scheme for boxcars will be more difficult and dislocating than the 1981 deregulation order?

Answer. While this exemption involves considerably more traffic than the TOFC/COFC exemption, the transition should not be any more difficult, because the ICC has retained the industry's anti-trust immunity to set car service and car hire rules collectively. As the answer to questions 3 and 7 indicates, the railroads are currently establishing the new rules needed to comply with the ICC's order, and should have them in place by November.

Question. Does the DOT agree that many of the shortline railroads lack any real bargaining power in negotiating car hire with a Class I railroad such as Conrail?

a. If DOT does not agree, what kind of bargaining power do the shortlines have?

b. if DOT does agree, what should the Commission do to redress that balance?

Answer. Many shortline railraods which own or lease equipment are themselves owned by large shippers, such as Georgia-Pacific Corp. and Weyerhauser Co. Such shippers generally have considerable leverage with a railroad through the traffic they control. Additionally, shortline railroads with car fleets may elect to join the newly-proposed car service and car hire pool currently under review by the ICC. The pool, if approved, will consist of boxcars of all the pool members. All members' cars will be treated equally, and participating carriers will be guaranteed a set payment per car loaded. Both BRAE and ITEL Corporation (another car leasing firm) are reported to be considering joining the pool.

Senator **Danforth**. Thank you very much, Mr. Till.

It is now 25 until 12, and we have three panels with a total of eight witnesses. I would hope that the witnesses could stay within their allotted time.

The first panel is a railroad panel, Mr. Dempsey, Mr. Snow, Mr. Boyce, and Mr. Marshall. I have had several requests from Senators that questions to various witnesses be submitted to them so that they might be answered for the record, and we would ask the indulgence of the witnesses for that purpose.

Mr. Dempsey.

STATEMENTS OF WILLIAM H. DEMPSEY, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS; JOHN SNOW, SENIOR VICE PRESIDENT OF CORPORATE SERVICES, CSX CORP.; ALLAN BOYCE, VICE PRESIDENT OF PUBLIC AFFAIRS, BURLINGTON NORTHERN, INC.; AND CHARLES N. MARSHALL, VICE PRESIDENT OF MARKETING, CONSOLIDATED RAIL CORP.

Mr. **Dempsey**. Thank you, Mr. Chairman.

I will say that as a general proposition we subscribe to the statements that have been made already this morning about the Staggers Act. That is to say, while it has not been a cure all by any means for the industry, we think it has been helpful.

Virtually every question that has been asked about a proceeding is about a pending proceeding, so we do not know what the final shape of regulation is going to be under Staggers, and will not know for some time.

So, in normal circumstances I would think that the sensible thing to do would be to wait and see how things develop, but there has been a clamor, at least from the coal industry and the utility industry, for change. I think therefore it would be instructive to see what has really happened with respect to coal rail rates both before and since Staggers, to see if there is anything here but apprehension, if there are any facts behind any of this. I would like to concentrate therefore on the coal issue and to illustrate what has been happening with respect to shippers as a class that allege themselves to be captive.

I will just begin with a very summary description of what has been happening in terms of the financial strength of the industry. As you can see, in 1980, a 4.1-percent rate is an anemic rate of return when compared with the 12.1 percent current cost of capital. Still, I should say that that is the best year that we had in about 30 years. So, while we are not home free by a long shot, and we have a terrible gap to close, still and all, that showed some promise. In the next year our cost of capital ladder became longer, and we fell down a little bit on it, but still not too bad.

Senator **Danforth**. You are talking about rate of return on what?

Mr. **Dempsey**. Net investment. A comparison of the rate of return on equity in 1982 would show, according to Citibank, 5.6 percent for the railroads. It put us fifth from the bottom of the 43 industries that Citibank ranks. The utilities, on the other hand, had a 14-percent rate of return on equity. That put them in the top 15 on the list of 43.

Now let me go to coal rates. First, compare coal prices and railroad coal rates in the last 10 years. As you can see, coal prices escalated more rapidly than coal rail rates, so that between 1971 and 1982, the rail rate as a percentage of the destination price fell from 34.4 percent in to 30.5 percent.

This chart takes it back to 1931. As you can see, in 1931, the rail rate as a percentage of the destination value was about 60 percent. That has fallen now to 30.5 percent, and indeed, in only of the last five decades, the 1950's, did rail rates go up more rapidly than coal prices.

This, I think, is perhaps even more striking. Taking the Bureau of Labor Statistics Index, in terms of constant dollars in this 11-year period, rail rates have actually gone down. So in 1982, the railroads were collecting less for the transportation of coal than they were in 1971.

The opposite has happened with respect to coal prices. As you can see, this is another way of looking at the same phenomenon I have been describing. Coal prices in terms of constant dollars I have gone up 32 percent, from an index of 100 to an index of 132, during the same period of time.

Now let us look at Staggers, post- and pre-Staggers. We have taken the same period of time before Staggers as we have had since Staggers. As you can see, the rate of increase in rail rates after Staggers has been just about half as much as it was before Staggers. The annual average increase of 17.2 percent pre-Staggers and an annual average increase of 9.1 percent since Staggers.

And if you look at the most recent 18-month period, taking again not our figures but the Bureau of Labor Statistics' figures, you can see we have had in that whole period of time only a 2.4-percent increase in coal rates. And if you look at the last 6 months, you will see that the figures are exactly flat.

Now, that is what has been really happening in the marketplace with respect to coal rates.

Senator **Danforth**. Can you finish up pretty quickly, Mr. Dempsey?

Mr. **Dempsey**. Yes, I sure will. This will take just a couple of seconds.

This simply compares what has happened to coal rates with what has happened to utility prices. Utility prices have gone up substantially higher and at a more rapid pace than rail rates.

This is just an indication of where coal ranks in terms of revenue produced for the rail industry. As you can see, it ranks 15th. There are 14 other major commodity groups that produce more revenue per ton originated than coal.

I think this is my last one. This just shows the same thing, except it is calculated in terms of revenue per ton originated, and there coal ranks 18th on our list.

[The statement follows:]

STATEMENT OF WILLIAM H. DEMPSEY, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS

Mr. Chairman and Members of the Subcommittee, I am pleased to appear before you to review the railroad industry's experience under the Staggers Rail Act of 1980. After reviewing the background of the Act, I will address at length the attacks being made upon the Act and its implementation by some shippers, discuss the coal rate issue, and then offer a few comments on the regulatory exemption, joint rate cancellation, and non-railroad acquisition issues.

BACKGROUND

In enacting Staggers, the Congress came face-to-face with the realities of rail transportation in the United States in the 1980's. Staggers culminated a legislative process that began with the Emergency Rail Services Act of 1970. That Act was spawned by the bankruptcy of the Penn Central Railroad and numerous smaller railroads in the Northeast. The malady spread to the Midwest with the bankruptcies of the Rock Island and Milwaukee railroads. The consequences of a federal regulatory policy that had been out of tune with economic reality for at least 35 years had finally been manifested in a manner that could no longer be ignored.

By 1980, the railroads were carrying only ⅓ of all intercity freight. In the period 1946–1980, the railroads' share of the intercity freight market had been cut in half by competition from trucks and barges. Yet the railroads were still being regulated essentially as they had been in 1920. It was clear by 1980 that a federal policy premised on continued comprehensive regulation of the railroads could in time lead only to a nationalized rail system that would require massive government subsidies. If the railroads were to survive in the private sector, they had to be given the opportunity to operate like private businesses.

The essence of the Staggers Act is the emphasis it places on the attainment of adequate revenues by the railroad industry—the *sine qua non* to survival in the private sector—and upon the relinquishment of regulatory controls in favor of market controls to the maximum extent possible. These objectives are manifested in provisions which:

(1) Require the Interstate Commerce Commission to consider a carrier's revenue adequacy in determining whether a rate is reasonable.

(2) Establish a cost recovery index which permits railroads to raise rates quarterly as necessary to keep pace with inflation.

(3) Permit carriers in the period 1980–84 to increase rates by 6 percent per year in excess of the rate of inflation and place the burden of proof as to the reasonableness of such increases on the shipper. After 1984, the annual percentage is reduced to 4 percent. (It is to be noted that competition has made this a virtually unused provision.)

(4) Establish a jurisdictional threshold for rate regulation based on the revenue/variable cost ratio of the movement in question.

(5) Permit the railroads to enter into contracts with shippers.

(6) Encourage the Commission to exempt rail services from regulation when the service is of limited scope or regulation is not needed to protect shippers from abuses of market power.

(7) Encourage the Commission to expedite actions taken by the railroads to rationalize their systems and eliminate uneconomic assets.

What has been the effect of Staggers? In the past 2½ years, the railroads have not done well financially. They have suffered through the recession like all other businesses faced with stiff competition for their goods or services. The Commission has determined each year since 1978 the railroads' cost of capital—the return on investment the railroads should earn to attract and retain capital. In 1980, when the Interstate Commerce Commission determined their cost of capital to be 12.1 percent, the railroads earned a return on investment (equity and debt) of 4.1 percent. In 1981, when their cost of capital was determined to be 16.5 percent, the railroads earned a return of 4.0 percent. In 1982, with a cost of capital we estimate at 18 percent—the Commission has not yet issued its determination—the railroads' return on investment fell to 2.2 percent!

This is hardly the picture of a railroad industry getting rich off coal or any other kind of traffic. To the contrary, it is a picture of bare survival in a highly competitive world. The results could, however, have been much worse. Without Staggers, the railroads would not have had the flexibility to take those actions necessary to survive the worst recession in four decades—actions to remove uneconomic plant more readily, to adjust prices to meet competition, and to offer novel rates and services that better utilize equipment or attract new business. Such actions would have been impossible under the pre-Staggers regulatory regime.

There are several indicia of the positive impacts of Staggers. Although the 4.0 percent return on investment in 1981 and the 2.2 percent return in 1982 are dismal by almost any standard, they are measurably better than the returns experienced by the industry in the much milder recessions of 1969–70 and 1974–75. In 1970, the industry's return on investment shrunk to 1.7 percent and in 1975 it sank to 1.2 percent.

While the rail share of total intercity freight movements slipped some in 1982, there was an increase in 1981 over 1980. In the TOFC/COFC area, the gains have been quite dramatic. After a severe drop in 1980, the traffic moved up 4 percent in 1981 and almost 8 percent in 1982. This increase occurred in the face of declines in other rail carloadings of 5.0 percent in 1981 and 16.3 percent in 1982. More importantly, the growth of TOFC/COFC in 1982 reflects healthy competition with the motor carriers on truck-competitive traffic. The 8 percent gain in TOFC/COFC loadings between 1981 and 1982 occurred while motor carrier traffic was declining an estimated 7 percent on a ton-mile basis and 9 percent on a tonnage basis. (In the first half of 1983, as the recession has waned, TOFC/COFC loadings have increased almost 20 percent, well above the gains in the trucking industry.)

This ability to provide attractive price-service combinations in a highly competitive environment would have been impossible without the exemption from regulation of TOFC/COFC. Without doubt we would have repeated our experience in the 1975 recession when, under regulation, trailer and container loadings dropped 19 percent from the previous year's level while motor carrier traffic declined by only 8.3 percent.

Since passage of Staggers, railroads and their shippers have entered into more than 7,000 contracts. One major railroad reports that nearly 25 percent of its coal tonnage is now under contract. Two others report that they expect, respectively, some $300 million and $1 billion of revenues this year to come from contract movements. Another reports that one-third of its carloads are now under contract. The experience to date shows the contract authority to be a principal and growing marketing device of great benefit to the shipping community as well as to the railroads.

The Staggers Act has also benefitted shippers by inducing greater intramodal price competition through the limitations imposed on collective ratemaking. This is a trade-off the railroads accepted for the relaxation of regulation under Staggers.

While the final results are not in, the Act has lived up to its promise in these first three years. We are still a long way from achieving the goals of Staggers, but with that Act the railroads have been given some of the tools necessary to the task.

THE ATTACKS OF THE COAL AND UTILITY INTERESTS

Because we are still so far from achieving the goals of Staggers, I would like to focus my testimony today on the broad attacks being made on the Act and the Commission's implementation of it, attacks which are being led by the coal and electric utility industries. They are urging "reforms" that are really only thinly veiled attempts to secure special treatment at the expense of the railroads, other shippers and, ultimately, the taxpayers of this county. These attacks center on five issues:

The objective of revenue adequacy for the railroads
The concept of market dominance
The standards for determining the reasonableness of maximum rates
The application of the "Long-Cannon" criteria
The construction of the rail cost recovery index

Before discussing the merits of these attacks, I want to offer a few comments about procedure.

Each of these matters is or has been the subject of a full and lengthy rulemaking proceeding conducted by the Commission, followed by appeals to the courts. The issues are complex but involve essentially the application of economic concepts. In each instance the coal/utility interests have lost the argument as to the course of action dictated by sound economics. Their subsequent legal attacks have also fallen short. They are now seeking the substitution of politics for economics and reversion to a regulatory scheme that will once again permit the railroads to be used to further one special interest or another in the guise of serving some "national" interest. That was the approach this country took in the first 90 years of railroad regulation and the one which the Congress totally and, we would hope, irrevocably discarded in 1980.

If railroads are to survive in this country as private enterprises, the economic forces that drive and shape our private enterprise system have to be allowed to work in the railroad sector. In the final analysis someone has to pay for the services provided by the railroad industry. All of the proceedings at issue under Staggers bear in one way or another on the questions of who pays and how much should they pay.

The coal/utility interests do not like the answers that the sound application of economics provides—it's as simple as that. In no case concluded to date has the court determined that, in reaching its decisions implementing the key provisions of Staggers, the Commission has acted arbitrarily or capriciously in the legal sense of those terms. Neither have they in any other sense.

In the proceeding to establish standards and procedures for determining adequate revenue levels, Ex Parte 393, there were 34 filings by the parties comprising over 1,500 pages of comments. Submitted with the comments were the statements of 21 experts including professors of economics and finance from our leading universities, economic consultants, transportation consultants, management consultants, finance consultants, investment bankers, and public accountants. There was one filing on behalf of the railroad industry, 13 filings on behalf of the electric utilities, 11 filings by major industry groups representing some 3,000 corporations, 2 filings by federal departments, and 3 by state agencies.

Based on that record, the Commission issued a 30-page decision in March 1981 explaining in detail the rationale for the conclusions it reached—the principal one of which was that to be considered revenue adequate a railroad should be earning a rate of return on investment equal to the current cost of capital. The decision was upheld on appeal and a petition of certiorari to the Supreme Court was denied.

On February 18, 1983, the Commission instituted another proceeding, EX Parte 393 (Sub-No. 1), to refine the standards and procedures adopted in the initial proceeding. Comments were originally requested to be filed within sixty days. Because of the complexity of the issues, the parties requested and have obtained an extension to next September. Specific issues which the Commission will examine include the items of income, expense, and investment to be considered in calculating the return on investment (ROI), the use of multi-year data to determine revenue adequacy, inclusion of railroad affiliates in computing ROI, and the use of inflation-adjusted accounting in determining revenue adequacy. As in the initial proceeding, one can anticipate the filing of a large bookcase full of comments and expert opinion and a lenghty decision. The process makes it quite unlikely that any significant consideration will be overlooked by the parties or the Commission. And whatever the Commission's conclusions, it is equally unlikely that any party will be entirely pleased with the result.

Prior to Staggers, our national regulatory policy was, implicity, to consume rail assets at rate levels which would preclude their replacement. That policy was driving the railroads to bankruptcy. In mandating through Staggers the pursuit of an economically viable railroad system operating with a minimum of regulation, the Congress charted a wholly new course of railroad regulation. The concept of revenue adequacy in that context is a wholly new one. The concept of maximum rate reasonableness in that context is a wholly new one. The procedure the Commission is following in giving vitality to concepts such as these is full and fair. It has invited and received the best counselling available. I would urge that this Subcommittee not attempt to re-try these proceedings as some would have it do but rather that it takes this opportunity to reaffirm its commitment to the course set in Staggers. Both the railroads and the shippers have been experiencing regulatory withdrawal pains. Substantial and sometimes sharp adjustments have been required of both. But no informed observer can seriously argue that the national interest would be served by a reversion to the pre-Staggers regulatory concepts.

The attack on the adequate revenue standard

As mentioned earlier, the Commission determined in Ex Parte 393 that to be considered revenue adequate a railroad must be earning a rate of return on investment equal to the current cost of capital. In so doing it stated:

"The cost of capital is, by definition, the rate at which the market values investment funds. As we have said, investments earning less than the cost of capital will, in general, not maintain existing funding nor obtain new funding because investors will have sufficient opportunities to invest their funds elsewhere at a higher rate of return . . . . Once again, we want to make it clear that we will not and cannot guarantee any railroad a return equal to the cost of capital. A railroad, like any other firm, should earn such a return only if it provides a desired service in an efficient manner. We want to take great care, however, not to deny railroads the opportunity to earn the cost of capital."

In reporting out the Staggers Act, the Committee on Conference stated:

"The overall purpose of the Act is to provide, through financial assistance and freedom from unnecessary regulation, the opportunity for railroads to obtain adequate earnings to restore, maintain and improve their physical facilities while achieving the financial stability of the national rail system."

I submit that the Commission's decision in Ex Parte 393 is entirely in keeping with—indeed, essential to the attainment of—the overall purpose of the Act as stated by the Conference Committee. I do not mean to brush aside the concerns of shippers as to how the investment base of a railroad is to be determined or as to how the current cost of capital is to be determined. These are issues which the Commission will continue to address and perfect as time goes on.

But we should not let such side issues obscure the basic issue as to the proper standard. You will hear the argument that the Commission has developed "unrealistic measures" for determining revenue adequacy. Translated, this means that the Commission should have prescribed a *minimum* standard assuring only short-run survivability. The Commission addressed this argument in its decision:

"Funds flow analysis and other minimum standards of revenue adequacy . . . were and are appropriate as indicators only of the short term viability of railroads. They were and are inappropriate as indicators of long run revenue adequacy and are especially inappropriate as measures to limit rail pricing flexibility which is one of the roles the Rail Act accords revenue adequacy findings."

The name of the game being played by the coal and utility interests is to hold coal rates down by whatever means are at hand. That is not unusual. Every entrepreneur would like to hold down the prices of the goods he buys while raising the prices of those he sells. But arguing for a minimum revenue adequacy standard is an argument for ultimate bankruptcy. When advanced by interests as dependent on rail service as coal producers and electric utilities assert they are, it can only be because they are expecting that someone else will eventually pay the freight—presumably the Federal Treasury through subsidy or nationalization. It will not, as they would have you believe, be the shippers who are less dependent on rail service because that traffic would quickly disappear in the face of any significant rate increase.

The minimum standard urged for the railroads is not one the utilities would prescribe for themselves.[1] A comparison of their earnings with railroad earnings suggests why. Citibank publishes annually the return on equity for all major industrial groups.[2] In 1982, the railroads earned a return on equity of 5.6 percent which placed them ninth from the bottom of Citibank's list of 43 industries. The electric and gas utilities realized a return on equity of 14 percent which placed them in the top 15 on Citibank's list.[3]

In Ex Parte 436, the proceeding to determine the railroads' cost of capital (debt and equity) for 1982, the electric utility industry had four witnesses testify on the cost of equity capital issue. The average of these witnesses' estimates of the railroads' cost of equity was 14.5%—8.9% higher than what the railroads actually earned. The utilities offering these witnesses sought for themselves in state regulatory proceedings in 1982 an average cost of equity of 18.5 percent—four percentage points more than what they argued an equity investor would seek in the riskier railroad industry.

The returns on investment (ROI) of coal producers are not readily available because most coal producers are subsidiaries of larger energy firms or electric utilities. We have, however, been able to develop some data for 1982, a period when coal demand was declining and profit margins were, according to coal operators, sharply lower.[4] For example, the Peabody Coal Company with revenues of $1.3 billion in

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[1] Utilities consistently argue to state regulatory commissions and to the courts, and the courts have consistently held, that the minimum earnings to which a regulated industry can be held is a return on investment adequate to attract capital, i.e., the current cost of capital. Yet the utilities persist in arguing that the railroads should earn less than the minimum standards to which they themselves are entitled.

[2] An industry's cost of capital is a weighted average of two elements, the cost of debt and the cost of equity. Because equity carries more risk than debt, its cost is higher. Because an equity investment in the competitive railroad industry carries more risk than an equity investment in the monopolistic electric utility industry, the cost of equity in the railroad industry is higher.

[3] In an article appearing in the Public Utilities Fortnightly of June 9, 1983, the President of the Edison Electric Institute was bemoaning the financial conditions of the utilities reflected by the 14 percent return: "Actual earned return still lags behind the average return authorized by regulators, which in turn hardly matches the true cost of capital. . . . The rates charged for electric power must . . . provide a fair, reasonably competitive return to shareholders, who make new investments possible."

[4] The estimates are derived from the segment data in the annual reports to shareholders for the parent companies.

1982 had an estimated ROI of 14 percent. The Consolidation Coal Company, which is a subsidiary of Conoco, which has been acquired by DuPont, had revenues of $1.7 billion in 1982 and an estimated ROI of 11 percent. Island Creek Coal Company, which is owned by Occidental Petroleum, had an estimated ROI of 15 percent in 1982. The North American Coal Company, which has the distinction of being the only independent coal company in the top ten coal producers, had a 1982 ROI of 13 percent. The coal producing operations of Amax Corporation, which is a diversified mining and energy company, yielded an estimated ROI of 21 percent in 1982.

There was not a major railroad in the country with a return on investment even approaching these performances by coal producers. Because the argument is often made by the coal and utility interests that industry-wide railroad figures mask the fact that the principal coal hauling roads are inordinately profitable, it is instructive to compare the ROI's of the five major coal hauling railroads with the ROI's of these five coal producers (14, 19, 15, 11, and 21 percent, respectively):

Return on investment

[In percent]

Carrier:	*1982*
Burlington Northern	4.40
Chessie System	2.83
Norfolk & Western	8.01
Seaboard System	3.25
Southern System	5.45

By any measure, the railroad industry is still a long way from achieving the adequate revenue levels essential to long-run economic viability. And its earnings are far below those of its largest users and principal beneficiaries of its services.

The attack on market dominance

Like revenue adequacy, the attack on the market dominance regulation is bottomed on the notion that the economic forces affecting every other sector of American business are not operative in the rail sector.

The market dominance concept originated with the 4-R Act of 1976. That Act defined market dominance as "an absence of effective competition from other carriers or modes of transportation, for the traffic or movement to which a rate applies." The Act further provided that, if a rail carrier did not have market dominance over the transportation to which a rate applied, the Commission did not have jurisdiction to determine the maximum reasonableness of the rate.

In implementing the provision, the Commission established several rebuttable presumptions of market dominance—a rate in excess of 160 percent of variable cost, 70 percent or more of the traffic moving by rail, and the existence of a substantial investment in rail equipment by the shipper. These presumptions had been subjected to strenuous attack by the Federal Trade Commission and the Departments of Justice and Transportation, as well as the railroads. They were under active reconsideration by the Commission at the time Staggers was enacted—based in part upon a study undertaken for the Commission that showed them to be faulty.[5]

Following enactment of Staggers, which prescribed a revenue/cost jurisdictional threshold and thus specifically superseded one of the Commission's presumptions, the Commission concluded its reconsideration and issued a new rule adopting guidelines and eliminating the other presumptions. In its new guidelines the Commission stated that it would look at all evidence bearing on the question of whether effective competition existed. Most notably, it stated that it would consider the effect of product and geographic competition.

This decision (Ex Parte 320) is on appeal in the 5th Circuit. The full court has agreed to rehear the opinion of one of its panels which reversed the Commission on the basis of a technical (and, in our judgment, erroneous) reading of the law.

In issuing market dominance guidelines that take into account product and geographic competition, the Commission has construed competition in a manner that fully comports with economic theory and with reality as experienced by all other businesses in this country. The Commission's construction recognizes the fact that rail rates are not constrained only by the existence of point-to-point transportation alternatives. The existence of product competition is obvious. When the price of oil shot up during the OPEC crisis of 1973–74, the mine mouth price of coal almost doubled, going from $8.53/ton in 1973 in 1974. Quite clearly the price of oil had constrained the price of coal. This is especially true when, as is often the case, a utility has the ability to burn either coal or gas or oil.

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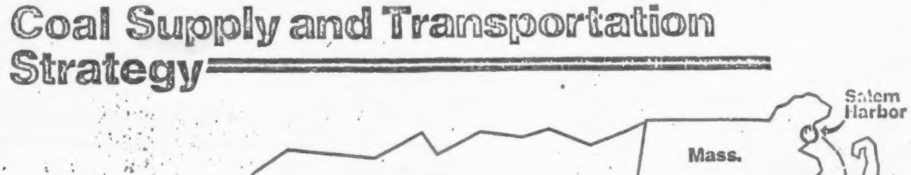
[5] The study, by the A. T. Kearney Co., concluded that less than 5 percent of rail traffic was "market dominant" in the long run and only 10–15 percent in the short run, whereas the application of the presumptions made more than half of all traffic "market dominant."

As I will show later, rail coal rates had been more depressed than the price of coal. Yet, prior to 1973, it would have been no more in a railroad's interest to increase its rates to the point that, at the delivered price, coal would have become noncompetitive with oil than it was in the coal producer's interest to raise the F.O.B. mine price of coal to that point. (It is to be noted that in the 1973–74 period when the unregulated coal price almost doubled, the regulated rail coal rates increased only 25 percent. Thus, most of the profit from the increase in the delivered price of coal was taken by the coal producer.)

Geographic competition is just as real in constraining the prices that either a coal producer or a railroad can charge. Eastern coal competes with western coal. West Virginia coal competes with Ohio coal. This point is made graphically in a letter to Congressman Rahall from the President of New England Energy, Inc., in which the latter complains, among other things, about the utilities' "captivity" to railroads. He enclosed the map on the following page as evidence, noting that coal cannot move without going over some railroad.

The map presents a perfect example of the geographic competition that constrains coal rates. It shows that New England Energy can get coal from three mine groups in three different states. The Pennsylvania group is served by Conrail, the West Virginia group by the Chessie (C&O, B&O), and the Virginia-West Virginia group by the N&W. The coal can be moved by those railroads through five different ports for connection with at least as many water carriers. New England Energy is no more captive to a railroad than it is captive to a mine or to a port or to a water carrier.


Coal Supply and Transportation Strategy
Salem Harbor
Mass.
New York
Providence
R.I.
Conn.
Pennsylvania
Brayton Point
Mine Areas
Ship Routes
Train Routes
Clearfield
Conrail
New York
Long Island
Conrail
Port Reading
Philadelphia
New Jersey
Kingwood
B&O
Maryland
Revolving Tonnage
3.7MM Tons/Yr
W. Virginia
Baltimore
C&D Canal
Delaware Bay
Del.
Atlantic Ocean
C&O
Chesapeake Bay
Thacker
Virginia
Newport News
N&W
Norfolk

The electric utilities are not suffering from captivity to railroads—they are suffering from regulatory nostalgia. They still yearn for the days when they could go to a regulation-bent Interstate Commerce Commission and argue that the public interest required the railroads to keep their rates at a near-bankruptcy level. They don't expect the coal producers to subsidize them but they still expect the railroads to. As the New England Energy map shows, they want rail regulation even when they are in a buyer's market with a host of mine-rail-port-water options, all of which they can play off against each other in obtaining the lowest delivered price.

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The same conditions exist with respect to the export market and explain the Commission's decision to exempt export coal from regulation. The foreign buyer's options are extended to the entire United States. He can get coal from Illinois, Kentucky, Ohio, Virginia, West Virginia, or Wyoming by truck-river-ocean, by rail-river-ocean, or by rail-ocean. Within the rail portion of these movements there is a good deal of competition among railroads. As shown by the preceding map, at least three major railroad systems compete for the movements to East Coast ports.

There are literally hundreds of combinations of mines, carriers, and ports available to the foreign buyer. Neither the mine price, the barge price, the port handling charges, or the ocean rates are regulated. All must be negotiated. Yet the coal producers and their buyers can find in this sea of competition that somehow they are captive to the railroads and that the rail rates—alone among all the prices that determine the delivered price of export coal—must be regulated.

The effect of refusing to consider product and geographic competition is to retain regulatory control over rates which are already constrained by competition. The first statement of the transportation policy of the United States in section 101(a) of Staggers is "to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail." In its guidelines for determining market dominance, the Commission has been quite faithful to that policy.

If, contrary to fact, product and geographic competition are ultimately decreed to be nonexistent as a matter of law, the objective of Staggers will have been dealt a staggering blow. Regulation will be imposed where market constraints abound. Rail rates will continue to be set by fiat while all other prices in the marketing chain are set by the interaction of the players. The coal interests will have won a major victory because, as the Council of Economic Advisers has pointed out: "[C]oal will sell at the highest price possible subject to competition from other fuels in the end-use market. If transportation rates drop, it will simply increase the return to owners of coal mines." The evidence showing that this nation's energy companies need to be subsidized by its railroads has yet to be adduced.

The attack on the maximum rate reasonableness standard

In enacting Staggers the Congress made a very conscious choice between two conflicting regulatory policies—whether to allow the laws of economics to work or to continue to regulate by the laws of political compromise. In coming down decisively on the side of economics, the Congress gave a mandate which the Commission must carry out. There is a logic in th laws of economics which may well lead to unpleasant results for those who have long enjoyed undeserved benefits—the "free lunch" for which somebody else invariably pays. This fact underlies the maximum rate reasonableness issue.

The law now provides that, if a railroad does not have market dominance over a shipper's traffic, the rail rate on that traffic cannot be regulated by the Commission. The reason is that, by definition, the shipper has alternatives available to him. He is not, in a word, "captive" to the railroad.

If a railroad is found to have market dominance, i.e., the shipper is a "captive" of the railroad, the Commission must regulate the rate. The issue then is what is the maximum rate that shipper ought to be charged?

In answering that question, the Commission has to consider one other mandate of Staggers—the railroad, *like the shipper,* must be given the opportunity to earn adequate revenues and the Commission must take that fact into account in determining the reasonableness of a railroad rate.

Prior to Staggers the Commission tried a formula approach to determining maximum rates. The courts struck that down as unsupported and arbitrary. And indeed it was. After several years of consideration and volumes of testimony in the coal rate standards proceeding, Ex Parte 347, the Commission has proposed a standard containing four elements. In evaluating this proposed standard, it is important to keep two considerations in mind. First, the railroad must be regulated in a manner that permits it to earn adequate revenues. Second, the rate at issue is being applied to a shipper who has come to the Commission and proclaimed itself to be "captive" to the railroad. What is the maximum reasonable rate under those conditions?

The four elements of the Commission's proposed standard are:

(1) the cost of serving the traffic without regard to any other traffic ("stand alone cost");

(2) checks on obviously inefficient management;

(3) achievement of revenue adequacy; and

(4) phasing of any substantial rate increases.

Let's look at each of these.

Stand Alone Costs. While there may well be legitimate disputes as to how stand alone costs should be calculated (and those disputes will be fully aired in Ex Parte 347), the use of stand alone costs as a maximum rate standard is entirely sound. The stand alone cost is the price ceiling that would be set in a competitive market, i.e., the revenue that a new entrant would have to earn to supply the service required by the shipper.

This concept can be explained by a simple example. If the shipper is captive, as it asserts, then it and the railroad are partners in the marketing of a product. In the case of coal, that product has little value while buried in the ground in Wyoming. It is given value by the process of mining (taking it out of the ground) and transportation (hauling it to the site where it can be burned). If a single firm were going into business to mine and transport the coal, it would demand a delivered price that would provide a return on the capital invested in the mine and the railroad at least equal to the current cost of capital. (That is the adequate revenue standard the Commission has adopted.)

The problem is conceptually the same when the single company example is changed to a two-company example—a mining company and a railroad company. They are each still entitled to a return on investment at least equal to the current cost of capital. The problem is now more complicated only because there are now two sets of books.

The problem becomes more complicated, but conceptually the same, if we add another shipper. What are "stand alone costs" if a railroad serves more than the "captive" shipper? Again, the complications introduced are in accounting and allocation rather than in concept.

Assume that a railroad serves only two shippers. One shipper ships canned fruits, a commodity that can be shipped by rail or truck. The other ships coal, which in this instance can only move by rail. The first shipper doesn't need the railroad at all and to the extent it uses rail and makes any contribution to the railroad's fixed costs it benefits the coal shipper by reducing the revenues necessary from that shipper. If we assume that at truck competitive rates, revenues from the first shipper would not be enough to cover the railroad's variable costs of moving its product and therefore that none of its traffic moves by rail, what is the maximum rate chargeable to the captive coal shipper? Quite clearly, it is a rate that will cover all of the costs (including return on investment) of providing rail service to that shipper. In this simplified example, it would be the cost of the entire railroad. To the extent the carrier could obtain traffic from the canned fruit shipper and realize some contribution to its fixed costs, the constraint of revenue adequacy would come into play to reduce the maximum rate chargeable to the captive shipper.

Moving from these simplified cases to the real world where a railraod may serve hundreds of shippers further complicates the accounting and allocation disputes but not the concept. As the Commission notes in discussing its proposal, "Both carriers and shippers agree that the stand alone cost represents the logical maximum rate that can be assessed. However, there is less agreement on how the stand alone cost should be computed." There is nothing inherent in the resolution of the method of computation that requires any change in the Staggers Act.

Checks on Obviously Inefficient Management. Here, the Commission is applying the Long-Cannon amendment (which is discussed in detail below) and simply saying to a complaining shipper that if it has any evidence that a railroad is carrying another shipper's traffic below its directly variable cost, and thereby imposing a revenue burden on other shippers, or evidence that other rates can be raised, that evidence will be taken into account in determining the maximum reasonableness of the rate being charged the complaining shipper.

In the past, the regulatory process held many rates down for a variety of reasons having nothing to do with the financial health of the railroads. With regulation effectively removed from such low rates, there is no reason to presume that a rational railroad manager is not going to charge rates that at least cover his directly varying costs and, in that regard, the Commission noted that ". . . we have not been presented with any evidence supporting the view of some shipper interests that the railroads are consciously carrying traffic at a loss or at suboptimal rates."

Achievement of Revenue Adequacy. The Commission states the rationale for this standard quite succinctly in its proposal:

"Congress has mandated that we assist the nation's railroads in attaining adequate revenues. . . . [A]dequate revenues are those which provide a rate of return on net investment equal to the current cost of capital. This is the revenue level necessary for a railroad to compete equally with other firms for the available sources of financing for maintenance, replacement, modernization, and, where required by the demand for its service, expansion of its facilities and services.

"We believe that if the other constraints described above are in force, the rate that a carrier charges its captive customers is not unreasonably high when the carrier's overall revenues are less than the revenue adequacy level. But once revenue adequacy is achieved, we must scrutinize the rates more closely."

If one is to take exception to this standard, it can only be on the ground that the railroads, unlike their shippers and competitors, do not need to attain adequate revenue levels—which is to say that the nation does not need an economically viable, privately-owned railroad system.

Phasing of Any Substantial Rate Increases. The Commission would limit any rate increase to 15 percent per year, plus any pass-through of inflation. Increases of such magnitude are justified in theory—the stand alone costs and adequate revenue levels are the logical limits—but, unfortunately, they are also possible only in theory. Because of the competitiveness of most rail traffic, little, if any, traffic would be susceptible to such increases, even where permitted. We recently conducted a survey among our member railroads to determine the extent to which they had utilized the "6 percent-in-excess-of-costs" rate increases authorized by Staggers for the purpose of helping the railroads achieve revenue adequacy (49 U.S.C. § 10707a(c)).[6] The survey shows that rate increases taken under this authority yielded the following increases in revenues:

[In percent]

	Coal	All other commodities
1981	0.46	0.29
1982	1.41	.32

Thus, by the end of 1982, of a total authorized increase of 12 percent, coal rates had taken less than two percent under this special authority and all other commodities less than one percent. These results fully confirm the fact that the laws of economics are indeed at work in the railroad sector and that competition is effectively constraining rail rates.

The Commission also notes that, even if a shipper is truly captive it may only be in the short run. Thus, the potential competition which a truly captive shipper can himself create in the long run would serve as a constraint on inordinate increases in rail rates. Where a shipper could not create even in the long run any potential competition to the railroad serving it (use of alternate fuels or creation of alternate facilities), then the stand alone cost and adequate revenue limits would provide equitable limits on rates.

To sum up, the Commission's proposed maximum rate reasonableness standard is conceptually sound and the proceeding now under way should resolve the issues with respect to its implementation.

The Attack on the Implementation of the Long-Cannon Amendment

In the course of its enactment, a provision was added to Staggers which became known as the "Long-Cannon amendment." The amendment (now section 10707a(e)(2)(B), (C) of Title 49, U.S. Code) requires the Commission to consider evidence of any inefficiencies in railraod management in determining the reasonableness of a rate. Specifically, it is to consider:

Whether traffic is being transported at rates which do not contribute to going concern value and efforts being made to minimize such traffic;

Whether the rates on traffic which contributes only marginally to fixed costs can be increased; and

Whether one commodity is paying an unreasonable share of a carrier's overall revenues.

The coal and utility interests' have seized upon this provision as a means of turning a shield into a sword that could be used to emasculate the Act.

On December 11, 1981, a group of electric utility and coal concerns petitioned the Commission seeking the institution of a rulemaking proceeding to implement the "Long-Cannon amendment." The effect of such a rulemaking, if carried out as proposed by the petitioners, would be to halt the application of differential pricing standards until the Commission had assessed the extent to which each railroad had a revenue shortfall due to the underpricing of its traffic. Without differential pricing a railroad could never achieve revenue adequacy—in fact, it could not long survive.

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[6] This section permits a total increase of up to 18 percent in the first four years following enactment.

In a decision of August 27, 1982, the Commission rejected the petition noting, among other things, that it would run counter to the intent of Staggers that the railroads be granted more managerial discretion:

"The Staggers Act granted the railroads significantly greater discretion to manage themselves. Petitioners' proposal runs counter to that policy. Their proposal would have the Commission develop rules for annual, carrier-by-carrier, commodity-by-commoodity elasticity studies. These rules would be extremely difficult to develop, and in the final analysis would rely upon subjective determinations applied to randomly sampled movements. The Commission would, in effect, oversee routine carrier pricing decisions to ensure that carrier management has fully maximized the revenue contribution from competitive traffic. We are convinced that the Staggers Act was intended to remove this type of regulatory burden and infringement on managerial discretion."

The Commission went on to note that:

The amount of data required would be "enormous and enormously difficult to gather";

It would require the railroads to determine the elasticity of demand on their competitive traffic, which because of the "sheer number of independent and interacting variables [is] an educated guess, at best"; and

It would, in the final analysis, "require the Commission to distinguish railroad losses (or failures to maximize revenues) that could be avoided from those that could not."

While, for those reasons, the Commission declined to enter into a general rulemaking proceeding, it did affirm that the Long-Cannon issues would be considered in individual cases.

The petition of the utilities and coal interests has very little to do with determining the efficiency of rail management—it has a lot to do with trying to stymie deregulation of the railroads. The enormous burden which the Commission found would be imposed by the proposed rulemaking has absolutely no relationship to the scope of the problem being addressed by Long-Cannon.

Regulation is often required to compel action that is not in the economic self-interest of the person being regulated. It is seldom, if ever, required to compel action that clearly serves a self-interest. Long-Cannon, in effect, requires the Commission to consider whether a railroad is charging less for its services than shippers are willing to pay. There may well be cases where a railroad has not correctly assessed the elasticity of demand for a particular service—as the Commission said, that process inolves educated guesses—bu those are certainly going to be the exceptions.

I must say I get a little weary of having to counter arguments that are premised on wholly irrational conduct by railroad management. The coal and utility interests are besieging Washington and, seemingly, every town meeting with assertions about the railroads' monopoly powers in the setting of coal transportation rates. But the fact is that the average coal rate has never been half as much as the average rate on all other commodities. The average coal rate in 1960 was 44 percent as high as the average rate on all other commodities. In 1982, it was 44.1 percent as high. If railroad management has a monopoly pricing power in the transportation of coal, why have they been unable to raise those rates significiantly more than they have raised rates on competitive traffic? And, if rail rates on competitive traffic have been kept below what the market would bear, why is it that the railroads have suffered a steady decline in market share over the past 30 years.? Anomalies such as these never get in the way of those who are ringing the "railroad monopoly"alarm.

With respect to Long-Cannon, the monopoly bellringers are arguing in effect, that railroad managers are so fat, dumb, and happy sitting on their monopoly profits that they have no interest in raising rates on shippers who would be willing to pay more if they were but asked. In defending against a rulemaking petition based on that premise, the railroads have gone through a long administrative proceeding and a court appeal—and, given the apparently boundless anti-Staggers litigation fund of the utilities and coal interests, we will surely not stop short of the Supreme Court.

Railroad managers are presiding over firms that in 1982 earned a return on investment of only 2.2 percent. Are these the kinds of earnings one would expect from monopoly power? Does this bare subsistence level provide no incentive to rail management to price *all* of its traffic at levels that yield maximum returns? The Commission was clearly right in concluding to the contrary. Their proposal to look at any Long-Cannon allegations on a case-by-case basis is fully consistent with the law and eminently sensible.

The attack on the rail cost recovery index

The Commission is conducting two proceedings relating to the rail cost recovery index. The basic proceeding is Ex Parte 290 (Sub-No. 2) and, through that proceeding, the Commission is continuing to refine the composition and preparation of the index.

The major point of contention with respect to the index has been whether it should include a productivity factor. The use of such a factor would offset cost increases to the extent railroads realized productivity gains and, if applied logically, would augment cost increases to the extent the railroads experienced losses in productivity.

In its initial decision, the Commission declined to include a productivity factor but stated that it would keep the matter under review. The Court of Appeals upheld the Commission's decision. The Commission instituted a proceeding a year ago (Ex Parte 290 (Sub-No. 40)) to again examine the productivity issue. It is now evaluating comments of interested parties.

The railroads have objected to the inclusion of a productivity factor on several grounds:

1. Accurate measurement of current rail productivity is impossible. Change in rail output per unit of input are just as likely to be the results of factors unrelated to productivity. For example, changes in the business cycle, in relative input prices, and in the mix of traffic have nothing to do with productivity and cannot be isolated from real productivity gains.
2. Rail transportation rates are subject to constantly increasing competitive pressures which have resulted already in a significant transfer of productivity gains to shippers in the form of rate reductions, hold downs, and flag outs. These pressures, which are increasing, can be expected to result in ever greater pass throughs in the future. Hence, requiring a pass through of productivity gains would over compensate shippers by double-counting these gains. In turn, this would effectively prevent the railroads from fully recovering the effects of inflation.
3. Even if accurate measurement were possible, the automatic pass-through of productivity gains is wrong in concept. The railroads should be permitted to retain as much of their productivity gains as the markets permit. In an unregulated and competitive market, innovators retain a share of productivity gains through increased business or increased profits or both for significant periods of time. While competition eventually drives down prices to levels reflecting current costs, this process may take years, during which the innovator has had the benefit of his gains. A mandated productivity adjustment requiring an immediate pass through of productivity gains would eliminate the incentive for innovation, as any prospect of profiting therefrom for any significant period would be lost.
4. As long as the railroads are so far below adequate revenue levels, reducing the pass-through of cost increases by what would inevitably be a highly questionable productivity factor is contrary to the objectives of the Staggers Act.

Obviously, the productivity issue is both technical and complex. The Congress has left the matter to be dealt with at the Commission's discretion. The other issues involved in the indexing procedure are being dealt with by the Commission in an orderly fashion. Certainly, there is no need for legislative action at this time.

THE COAL RATE ISSUE

In discussing the arguments of the coal and utility interests, I limited my comments to the rationale for maximum rate regulation under Staggers as it is being developed by the Commission in Ex Parte 347. I would now like to review for the Committee the underlying facts with respect to coal rate levels and the interests of the parties involved in the dispute.

The Level of Rates. The electric utility industry and the coal producing industry are allied in an effort to convince the public and the Congress that in the entire energy market the only prices that are out of line are the rates charged by the railroads for moving coal. Time does not permit a complete examination of the self-serving interests that underlie this joint assault. Any inquiry should examine, however, the ownership of coal mines by electric utilities and the fact that the prices utilities are allowed to charge themselves for coal from their own mines is dependent upon the prices charged by competing mines. Consequently, those who are purchasing coal from themselves have a strong interest in maintaining a high price for coal.

The self-interest of others in the coal production and marketing chain are so patent as not to require much examination. Coal sells at a delivered price that is competitive with other fuels. The lower the transportation share of the delivered price, the larger the share that can be taken by others in the production and marketing chain.

Several salient facts emerge from the data which follows: (1) coal rates have not increased as rapidly as the price of coal itself, (2) they have not increased inordinately in relation to rates on other commodities, and (3) they have not increased inordinately since enactment of Staggers.

The fact that rates have not increased inordinately since Staggers deserves special comment. The coal and utility interests are alleging great injury at the hands of the railroad industry because of the "license" granted by Staggers. After examining the facts one can only ask "What injury?" Between April 1978 and October 1980, the average annual increase in coal rates was 17.2 percent. Between October 1980 and April 1983, the average annual increase in rates was 9.1 percent. If we take inflation into account, we find that the pre-Staggers increase was 3.3 percent in excess of the inflation rate, and in the post-Staggers period it was only .3 percent in excess of the inflation rate. For the past six months the rate level has been virtually flat and was the same in June as it was in January.

Certainly, these facts do not support the claim of injury. Such a claim becomes even less tenable when we look at the data over more extended periods of time.

	Mine price	Rail rate	Total	Percentage of destination value	
				Coal	Rail rate
Year:					
1931	$1.54	$2.22	$3.76	$41.0	$59.0
1941	2.19	2.22	4.41	49.7	50.3
1951	4.92	3.16	8.08	60.9	39.1
1961	4.58	3.40	7.98	57.4	42.6
1971	7.07	3.70	10.77	65.6	34.4
1972	7.66	3.67	11.33	67.6	32.4
1973	8.53	3.78	12.31	69.3	30.7
1974	15.75	4.71	20.46	77.0	23.0
1975	19.23	5.25	24.48	78.6	21.4
1976	19.43	5.86	25.29	76.8	23.2
1977	19.82	6.48	26.30	75.4	24.6
1978	21.78	7.32	29.10	74.8	25.2
1979	23.50	8.15	31.65	74.2	25.8
1980	24.65	9.49	34.14	72.2	27.8
1981	26.29	11.33	37.62	69.9	30.1
1982	27.30	11.96	39.26	69.5	30.5

Note that:

Between 1931 and 1941, coal prices increased 42 percent. Rail rates did not increase one penny.

Between 1941 and 1951, coal prices increased 125 percent. Rail rates increased only 42 percent.

Between 1951 and 1961, coal prices decreased by 7 percent. Rail rates increased only 8 percent.

Between 1961 and 1971, coal prices increased 54 percent. Rail rates increased only 9 percent.

Between 1971 and 1981, coal prices increased 272 percent. Rail rates increased only 206 percent.

Over the entire period, the coal producers' share of destination value (delivered price) has increased from 41 percent to 69.5 percent; and during the period 1974–1980 their share was well in excess of 70 percent and went as high as 78.6 percent.

In the twenty year span 1951–1971, the price of coal increased 44 percent while rail rates increased only 17 percent. It is clear that the regulatory system required railroad rates to bear the brunt of the competitive fight with oil and gas during that period. It is a return to that regime that is sought by the utilities and coal producers.

If the rail share of the delivered price of coal were the same in 1982 as it was in 1951 (the first post-war year shown), the average rail rate in 1982 would have been

$15.35, or 28 percent higher than the actual rate of $11.96. If rail rates had increased as much as coal prices during that period, the 1982 rate would be $17.53, or 46 percent higher.

There is nothing in the above data to suggest that increases in rail rates have been disproportionate to increases in coal prices. This fact becomes even more clear when the inflation factor is removed. A comparison of coal prices and rail coal rates in constant dollars shows that the latter have declined 3 percent since 1971 while the former have increased 32 percent in the same period. This means that in "real" dollars the railroad industry is receiving less per ton of coal handled today than it did before the energy crisis and that coal producers are receiving revenues far in excess of their rate of inflation.

	Constant dollar domestic price of coal		Constant dollar rail coal rates	
	Per ton FOB mine [1]	Index	Rates [2]	Index (1971 = 100)
Year:				
1971	$7.07	100	123.9	100
1972	7.27	103	118.3	95
1973	7.49	106	108.3	87
1974	11.84	167	110.8	89
1975	12.50	177	111.6	90
1976	11.59	164	113.3	91
1977	10.96	155	110.8	89
1978	10.96	155	110.1	89
1979	10.63	150	114.1	92
1980	9.83	139	114.5	92
1981	9.48	134	116.4	94
1982	9.35	132	119.8	97

[1] Actual FOB mine price adjusted by coal production input cost index.

BLS rate index (1969 = 100) adjusted by AAR price index.

The fact that the export coal producers are also taking the lion's share of price increases in that market is borne out by an observation made by the Commission in its decision exempting export coal from regulation:

"The railroads have argued that if export coal rates are deregulated they will be able to negotiate the shares of the available economic rents between every link in the export chain . . . it is useful to observe how these economic rents have been divided in the past when the delivered price of coal has risen sharply due to world oil shortages. Between 1969 and 1974 minehead prices (in current dollars) increased 468 percent, while export rail rates rose only 57 percent. Coal prices (in real dollar terms) as of December 1981 were more than two and a half times greater than they were in 1969, but export rail rates increased by less than half. These results indicate at a minimum that the unregulated shippers of export coal have considerable economic bargaining power in the contest over division of the economic rents from export coal."

How about the coal producers' partners in the assult on these "outrageous" increases in rail rates, the electric utility industry? Let's compare their rate increases with coal rate increases since enactment of Staggers:

	BLS: Railroad coal rates	Average revenue per KWH sold—Electric utility industry
Oct. 1, 1980	100.0	100.0
4th quarter 1980	100.2	101.0
1st quarter 1981	105.9	104.3
2d quarter 1981	107.6	107.5
3d quarter 1981	112.7	111.4
4th quarter 1981	114.9	114.9
1st quarter 1982	119.9	126.3
2d quarter 1982	120.2	129.0

	BLS: Railroad coal rates	Average revenue per KWH sold—Electric utility industry
3d quarter 1982	122.1	131.3
4th quarter 1982	122.1	132.7

The fact that the increase in utility rates has substantially exceeded the increase in rail coal rates helps explain why the return to the shareholders' interest in the railroad industry was only 5.6 percent in 1982 whereas the utilities realized a hefty 14 percent return on their share-holders' interest.

It seems paradoxical that the electric utilities, while loudly condemning the rail rate increases which they pass along to their customers, have quietly accepted the more rapidly escalating price increases for coal which they have also passed along to their customers. This might be explained by the fact that the top 18 coal mining companies owned by electric utilities produced over 89 million tons of coal in 1979—almost one-fifth of the total of 499 million tons produced by the top 50 coal groups in the U.S. The coal reserves owned or controlled by electric utilities are, of course, measured in the billions of tons. Therefore, the transfer of even one dollar of the delivered price of coal from the rail rate to the coal price could mean potentially billions of dollars to the electric utilities and their shareholders (although not to their customers whose bills would still reflect the delivered price of coal).

The Cross-Subsidy Argument. The electric utilities and coal producers also argue that coal rates are too high relative to the rates on other commodities moving by rail and that, because of differential pricing, coal is being required to bear a disproportionate share of the railroads' revenue needs and, thus, to subsidize the movement of other commodities. One glaring fact which they conveniently ignore in making this argument is that coal rates, too, reflect differential pricing.

As shown in the table on page 27, the average coal rate in 1982 was $11.96/ton. In the West, where coal may be hauled as far as 1500 miles, coal rates may exceed $20/ton. Quite obviously, a lot of coal is being hauled at rates well below the national average of $11.96. It is also quite obvious that cost differentials alone do not account for the wide spread in coal rates. The other factor that does account for that spread is the wide variation in demand for rail transportation (as well as for the coal itself). In many markets, the rail transportation rates are being held down by product, geographic, modal, or intermodal competition. In those markets coal is being carried at rates that cover the railroad's variable costs but not its full costs. To the extent such competitive movements exceed variable costs and make some contribution to fixed costs, movements in the so-called "captive" markets benefit because to that extent their rates are lower than they otherwise would be. Ironically, if the railroads were forced to move to the cost-based pricing urged by the utilities and coal interests, coal shippers along with all other shippers would suffer and the railroads would rather quickly go out of business.

Given the need for differential pricing of all commodities moving by rail, are coal rates disproportionately high relative to the rates for other commodities?

First, let's compare the average rate in cents/ton on coal with the average rate in cents/ton on all other commodities:

	Bituminous coal and lignite (1)	All commodities except bituminous coal and lignite (2)	Percent column 1 is of column 2 (3)
Year:			
1960	340	773	44.0
1961	340	781	43.5
1962	332	789	42.1
1963	321	780	41.2
1964	311	771	40.3
1965	313	786	39.8
1966	301	794	37.9

	Bituminous coal and lignite (1)	All commodities except bituminous coal and lignite (2)	Percent column 1 is of column 2 (3)
1967	300	812	36.9
1968	301	855	35.2
1969	311	878	35.4
1970	342	920	37.2
1971	370	1,053	35.1
1972	367	1,077	34.1
1973	378	1,113	34.0
1974	471	1,271	37.1
1975	525	1,390	37.8
1976	586	1,539	38.1
1977	648	1,702	38.1
1978	732	1,782	41.1
1979	815	1,982	41.1
1980	949	2,254	42.1
1981	1,133	2,549	44.4
1982	1,196	2,709	44.1

Note that:

Coal rates have never been even half as high as the average rate on all other commodities.

The decline between 1960 and the OPEC crisis in 1973 demonstrates the extent to which coal rates were depressed relative to other commodities.

There has been a gradual increase in coal's relative position in the nine years since the OPEC crisis, but that increase has only brought coal rates back to the relative position they occupied in 1960.

The electric utilities and coal producers did not seek legislative relief from differential pricing during the 1960–73 period when that practice held coal rates down because of oil and gas competition. Differential pricing is attacked only when rail rates are permitted to rise because of a rise in the demand for coal. Apparently, unlike the pricing practices in the coal business itself, rail rates are supposed to be low in the good years as well as in the bad.

Second, compare revenue yield per ton for the leading commodity groups:

Rank	STCC No.	Commodity	Revenue per ton originated
1	37	Transportation equipment	$104.48
2	012 013	Farm products other than field crops	55.14
3	26	Pulp, paper and allied products	47.14
4	08	Forest products	35.79
5	20	Food and kindred products	33.8
6	28	Chemicals and allied products	32.27
7	33	Primary metal products	30.51
8	204	Grain mill products	29.20
9	29	Petroleum and products	28.04
10	32	Stone, clay and glass products	23.26
11	24	Lumber and wood products	19.79
12	40	Waste and scrap material	18.38
13	29913 29914	Coke	17.63
14	011	Field crops	16.21
15	11	Coal	12.04
16	14	Nonmetallic minerals	10.06
17	142 144	Crushed stone, gravel and sand	9.56
18	10	Metallic ores	6.44

Note that:
Coal is 15th on the list in terms of revenue per ton.
Third, compare the revenue per ton-mile for the leading commodity groups:

Rank	STCC No.	Commodity	Revenue per ton-mile (cents)
1	37	Transportation equipment	11.51
2	40	Waste and scrap materials	5.79
3	204	Grain mill products	4.93
4	29	Petroleum and products	4.89
15	33	primary metal products	4.64
6	26	Pulp, paper, and products	4.57
7	29913 29914	Coke	4.47
8	20	Food and kindred products	4.37
9	32	Stone, clay and glass products	4.29
10	28	Chemicals and allied products	4.20
11	24	Lumber and wood products	4.12
12	08	Forest products	3.90
13	10	Metallic ores	3.84
14	142 144	Crushed stone, gravel, and sand	3.54
15	14	Nonmetallic minerals	3.43
16	012 013	Farm products other than field crops	3.02
17	011	Field crops	2.81
18	11	Coal	2.51
		All commodities	3.18

Note that:
Coal provides the lowest yield per ton-mile of all the leading commodity groups.
Coal yields less revenue per ton-mile than other low-value commodities such as crushed stone.
Coal yields far less revenue per ton-mile than other bulk commodities such as chemicals and coke.
Fourth, compare the revenues yielded by leading commodity groups with the relative use of the rail system by those groups:

STCC No.	Commodity	Percent of total tons	Percent of total freight revenues
11	Coal	41.3	23.8
01	Farm products	10.5	8.7
28	Chemicals and allied products	7.2	11.1
14	Nonmetallic minerals	6.7	3.2
20	Food and kindred products	6.0	9.8
24	Lumber and wood products	5.2	4.9
10	Metallic ores	4.9	1.5
32	Stone, clay, and glass products	3.0	3.4
26	Pulp, Paper, and allied products	2.9	6.5
33	Primary metal products	2.5	3.7
29	Petroleum and coal products	2.5	3.3
40	Waste and scrap material	1.8	1.6
37	Transportation equipment	1.5	7.4
	Subtotal	96.0	88.9
	All others	4.0	11.1
	Total	100.0	100.0

Note that:

Coal accounts for 41 percent of the railroads' tonnage but only about 24 percent of the railroads' revenues.

Most other commodities provide a share of revenue about equal to or in excess of their share of tonnage.

The four highest contributions of revenue relative to tonnage together provide one and one-half times as much revenue as coal but impose on the system only 43 percent as much tonnage.

Farm products impose only ¼ as much tonnage on the system as coal but yield 37 percent as much in revenues.

Chemicals impose only about ⅙ as much tonnage on the system as coal but yield 47 percent as much revenue.

Finally, if tonnage is considered a biased measure due to the heavy loading of coal, compare coal's use of the rail system on a carload basis:

STCC No.	Commodity	No of carloads	Percent of total carloads	Percent of total revenues	Rank in rev/carload
11	Coal	5,718,000	30.8	23.8	10
01	Farm Products	1,566,000	8.4	8.7	8
28	Chemicals and Allied Products	1,120,000	6.0	11.1	1
14	Nonmetallic Minerals	958,000	5.2	3.2	12
20	Food and Kindred Products	1,391,000	7.5	9.8	6
24	Lumber and Wood Products	1,002,000	5.4	4.9	9
10	Metallic Ores	761,000	4.1	1.5	13
32	Stone, Clay and Glass Products	516,000	2.8	3.4	7
26	Pulp, Paper and Allied Products	765,000	4.1	6.5	3
33	Primary Metal Products	459,000	2.5	3.7	4
29	Petroleum and Coal Products	467,000	2.5	3.3	5
40	Waste and Scrap Material	409,000	2.2	1.6	11
37	Transportation Equipment	801,000	4.3	7.4	2
	Subtotal	15,933,000	85.7	88.9	
	All others	2,653,000	14.3	11.1	
	Grand total	18,586,000	100.0	100.0	

Note that:

Coal ranks near the bottom of the list on a revenue per carload basis.

Chemicals yield almost half as much revenue as coal with only one-fifth as many carloads.

The four highest contributors in revenues per carload yield 21 percent more revenue than coal while utilizing only about half as many carloads.

To sum up, there is simply no evidence that coal rates are too high or that they have been disproportionately increased. To the contrary, the facts show rather clearly that coal rates are too low relative to the railroad industry's revenue needs and to coal's use of the rail system.

REGULATORY EXEMPTIONS

The Commission's exemption authority was broadened significantly by Staggers. In its report, the Conference Committee stated its expectation that the power be used to reduce the Commission's exercise of authority "to instances where regulation is necessary to protect against abuses of market power where other federal remedies are inadequate for this purpose." Since Staggers, the Commission has exempted from regulation TOFC/COFC traffic, agricultural products (other than grains, soybeans and sunflower seeds), export coal, boxcar traffic (the latter two to become effective this fall), and a variety of less significant individual commodities. it has also exempted the railroads from the "long-haul, short-haul" provision (49 U.S.C. § 10726).

The Association of American Railroads generally supports the continued availability and use of the exemption authority. The exemptions for TOFC/COFC traffic and agricultural products appear to be working satisfactorily. Numerous implementation problems were encountered in moving from the regulated to the unregulated environmental in the case of TOFC/COFC traffic, but they are in the process of being resolved without undue disruption. Traffic is up, service has improved, and rates are down in terms of constant dollars.

I have already stated in another context why I believe the exemption of export coal is entirely consistent with the letter and intent of the law and why the railroads should cease to be the only regulated link in the export coal market chain (see page 14). I would, however, like to add one other observation. As noted by the Commission, its export coal decision, between 1969 and 1974 the minehead price of export coal increased 468 percent while export coal rail rates increased only 57 percent and, in constant dollars, between 1969 and 1981 export coal rates increased 250 percent while export coal rail rates increased less than 50 percent. I would also ask you to recall, in this context, the returns on investment in 1982 of some of the largest coal producers (they ranged between 11 percent and 21 percent). In the face of these facts, how often have we heard the charge that it is the level of export coal rail rates that is destroying the competitiveness of U.S. coal in foreign markets. There is a Yiddish word that captures the character of that charge—it is "chutzpah." The English word is "gall."

The members of the Association do not share a common view with respect to the decision to exempt boxcar traffic. I will, therefore, leave any comments on that decision to the individual railroads.

JOINT RATE CANCELLATIONS

There has long been a diversity of views among the members of the Association with respect to the circumstances under which joint rates should be maintained or cancelled. In a recent decision, the Commission has rejected a petition of the Natinal Industrial Traffic League that a rulemaking on the subject be initiated. It stated, however, that it would undertake an in-depth study of the changes that are occurring and take further action if necessary. In the meantime, disputes would continue to be handled on a case-by-case basis

I will leave discussions of the issues arising from past cancellation actions or pending cases to the railroads involved.

THE ACQUISITIONS OF NON-RAILROAD PROPERTIES

The propriety of acquisitions of non-railroad properties by railroad holding companies has been examined by the Congress and the Commission in the past and, to my knowledge, without any showing of injury to a railroad. The issue has been raised recently as a result of the acquisition of The El Paso Company by the holding company of the Burlington Northern railroad and the proposed acquisition of Texas Gas Resources Corporation by the holding company of the Chessie and Seaboard railroads.

Critics assert that it is unreasonable for these railroads to be deemed revenue inadequate when they are part of holding companies with resources to make multimillion dollar acquisitions. While a detailed discussion of the benefits of these acquisitions is best left to the railroads involved, I would like to offer a general observation.

One of several benefits of acquisitions of this type is the ability to reduce risk through diversification. The demand for transportation services is closely tied to the nation's GNP and, as such, is often sharply cyclical. As a result, railroad earnings vary greatly. Railroads—like other corporations—should be allowed the opportunity to diversify into other lines of business, hoping to smooth out the high and low earnings levels of each lines of business. Such "smoothing" benefits everyone. Cash is available for investment in railroad activities even when short-term demand is low. In addition, investors perceive the reduced variation in earnings of the parent company as a benefit and permit the company to acquire debt and equity funds at a lower cost. This lowers the railroad's cost of capital and, thereby, enhances its opportunity to reach an adequate revenue level.

If such investments were viewed as a liquidation of railroad property, there might be possible reason for alarm; but, investment in railroad plant is exemplary. During the ten-year period 1972–1981, capital expenditures have exceeded cash flow (ordinary income plus depreciation) by over six billion dollars.

Furthermore, tieing revenue adequacy to a firm's ability to acquire another is financially absurd. The ability to acquire is a function of a firm's cash position and balance-sheet strength and has little to do with its current and future level of earnings. No firm in the competitive market is so constrained. Moreover, in the case of a holding company, the cash for a new acquisition may well come from the sale of a non-railroad asset and have no bearing whatsoever on the railroad that it also happens to own.

SUMMARY

To sum up, Mr. Chairman, in the 34 months that have elapsed since the Staggers Act took effect, the railroad industry has undergone significant changes in structure and in its ways of doing business. For rail management it has been a period of great promise and serious challenge. For both the railroads and their customers, it has been a period marked by major adjustments in the carrier-shipper relationship. While significant progress has been made, the railroads still have a long way to go in achieving the objectives set by the Congress in 1980. But of this I am certain—we are on the right track and for the Congress to reverse direction as some of the witnesses before you will urge would be a tragic mistake. Tragic for our economy and tragic for the transportation system on which it depends.

RAILROAD REVENUE ADEQUACY: ICC-DETERMINED

[In percent]

	Railroad cost of capital	Railroad rate of return
Year:		
1978	10.6	1.5
1979	11.7	2.9
1980	12.1	4.1
1981	16.5	4.0
1982	[1] 18.0	2.2

[1] Estimate of Association of American Railroads.

COAL PRICES AND RAILROAD COAL RATES

	Average price of coal per ton (FOB mine)	Average rail revenue per ton	Rail rate as a percentage of destination price
Year:			
1971	$7.07	$3.70	34.4
1972	7.66	3.67	32.4
1973	8.53	3.78	30.7
1974	15.75	4.71	23.0
1975	19.23	5.25	21.4
1976	19.43	5.86	23.2
1977	19.82	6.48	24.6
1978	21.78	7.32	25.2
1979	23.50	8.15	25.8
1980	24.65	9.49	27.8
1981	26.29	11.33	30.1
1982p	27.30	11.96	30.5

COAL/RAIL SHARE OF DESTINATION VALUE

	Mine price	Rail rate	Total	Percentage of destination value	
				Coal	Rail rate
Year:					
1931	$1.54	$2.22	$3.76	41.0	59.0
1941	2.19	2.22	4.41	49.7	50.3

COAL/RAIL SHARE OF DESTINATION VALUE—Continued

	Mine price	Rail rate	Total	Percentage of destination value	
				Coal	Rail rate
1951	4.92	3.16	8.08	60.9	39.1
1961	4.58	3.40	7.98	57.4	42.6
1971	7.07	3.70	10.77	65.6	34.4
1972	7.66	3.67	11.33	67.6	32.4
1973	8.53	3.78	12.31	69.3	30.7
1974	15.75	4.71	20.46	77.0	23.0
1975	19.23	5.25	24.48	78.6	21.4
1976	27.30	5.86	25.29	76.8	23.2
1977	19.43	6.48	26.30	75.4	24.6
1978	19.82	7.32	29.10	74.8	25.2
1979	21.78	8.15	31.65	74.2	25.8
1980	23.50	9.49	34.14	72.2	27.8
1981	24.65	11.33	37.62	69.9	30.1
1982	26.29	11.96	39.26	69.5	30.5

RAILROAD COAL RATES IN CONSTANT DOLLARS

	BLS rate index—Coal		Inflation AAR price index	Constant rates	
	1969=100	1971=100		BLS index—coal	(1971=100)
Year:					
1971	123.9	100	100.0	123.9	100
1972	128.8	104	108.9	118.3	95
1973	132.5	107	122.3	108.3	87
1974	154.8	125	139.7	110.8	89
1975	177.5	143	159.0	111.6	90
1976	199.6	161	176.1	113.3	91
1977	211.6	171	191.0	110.8	89
1978	228.2	184	207.2	110.1	89
1979	266.2	215	233.3	114.1	92
1980	306.3	247	267.6	114.5	92
1981	350.7	283	301.2	116.4	94
1982	385.0	311	321.5	119.8	97

COAL PRICES IN CONSTANT DOLLARS

	Current dollar domestic price of coal		Composite coal production input cost index [1]	Constant dollar domestic price of coal	
	Per ton FOB mine	Index		Per ton FOB mine	Index
Year:					
1971	$7.07	100	100.0	$7.07	100
1972	7.66	108	105.4	7.27	103
1973	8.53	121	113.9	7.49	106
1974	15.75	223	133.0	11.84	167
1975	19.23	272	153.8	12.50	177
1976	19.43	275	167.7	11.59	164
1977	19.82	280	180.8	10.96	155
1978	21.78	308	198.7	10.96	155
1979	23.50	332	221.0	10.63	150
1980	24.65	349	250.7	9.83	139
1981	26.29	372	277.2	9.48	134
1982	27.30	386	292.0	9.35	132

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[1] Composite index of major input costs influencing the delivered price of coal, Bureau of Labor Statistics, weighted as follows: Machinery 25 percent, hourly earnings 45 percent, electric power and fuel 5 percent, all other expenses 24 percent.

RAILROAD COAL RATES BEFORE AND AFTER THE STAGGERS ACT

[30 months]

Time Period	BLS coal freight rate index	
	1969=100	Base month=100
April 1978	222.5	100.0
October 1980	318.1	143.0
Average annual increase (percent)		17.2
October 1980	318.1	100.0
April 1983	390.4	122.7
Average annual increase (percent)		9.1

BLS RAILROAD COAL RATE INDEX

Period	BLS index	BLS index rebased
1982:		
January	381.2	100.0
February	381.2	100.0
March	381.2	100.0
April	381.5	100.1
May	382.6	100.4
June	382.4	100.3
July	388.8	102.0
August	388.8	102.0
September	388.9	102.0
October	388.9	102.0
November	388.8	102.0
December	387.5	101.7
1983:		
January	390.4	102.4
February	390.6	102.5
March	390.4	102.4
April	390.4	102.4
May	390.4	102.4
June	390.4	102.4

Source: U.S. Department of Labor, Bureau of Labor Statistics, Price Index for Railroad Freight of STCC 11, Coal.

RAILROAD COAL RATES AND UTILITY PRICES SINCE THE STAGGERS ACT

	BLS: Railroad coal rates (1)	Average consumer utility price index—utility (piped) gas (40 therms) (2)	Average revenue per kWh sold—electric utility industry (3)
Oct. 1, 1980	100.0	100.0	100.0
4th quarter 1980	100.2	99.9	101.0
1st quarter 1981	105.9	102.8	104.3
2d quarter 1981	107.6	108.1	107.5
3d quarter 1981	112.7	113.2	111.4
4th quarter 1981	114.9	118.0	114.9
1st quarter 1982	119.9	121.6	126.3
2d quarter 1982	120.2	131.0	129.0
3d quarter 1982	122.1	132.9	131.3
4th quarter 1982	122.1	143.5	132.7
1st quarter 1983	122.8	148.6	134.6

RAILROAD COAL RATES AND UTILITY PRICES SINCE THE STAGGERS ACT—Continued

	BLS: Railroad coal rates (1)	Average consumer utility price index—utility (piped) gas (40 therms) (2)	Average revenue per kWh sold—electric utility industry (3)
2nd quarter 1983	122.8	NA	NA

Source: Column 1: U.S. Department of Labor, Bureau of Labor Statistics, Price Index for Railroad Freight of STCC 11, Coal.
Column 2: U.S. Department of Labor, Bureau of Labor Statistics, Index computed from Average Consumer Prices, U.S. City Average, Utility Piped Gas, (40 Therms).
Column 3: Edison Electric Institute, Quarterly Statistical Reports.

REVENUE PER TON ORIGINATED: 18 LEADING RAILROAD COMMODITY GROUPS 1982

Rank	Commodity	Revenue per ton originated
1	Transportation equipment	$104.48
2	Farm products other than field crops	55.14
3	Pulp, paper, and allied products	47.14
4	Forest products	37.79
5	Food and kindred products	33.83
6	Chemicals and allied products	32.27
7	Primary metal products	30.51
8	Grain mill products	29.20
9	Petroleum and products	28.04
10	Stone, clay, and glass products	23.26
11	Lumber and wood products	19.79
15	Coal	12.04
	All commodities	20.89

REVENUE PER TON-MILE: 18 LEADING RAILROAD COMMODITY GROUPS, 1981

Rank	Commodity	Revenue per ton originated (cents)
1	Transportation equipment	11.51
2	Waste and scrap materials	5.79
3	Grain mill products	4.93
4	Petroleum and products	4.89
5	Primary metal products	4.64
6	Pulp, paper and allied products	4.57
7	Coke	4.47
8	Food and kindred products	4.37
9	Stone, clay and glass products	4.29
10	Chemicals and allied products	4.20
11	Lumber and wood products	4.12
18	Coal	2.51
	All commodities	3.18

(The following information was subsequently received for the record:)

Association of American Railroads,
September 14, 1983

Hon. John C. Danforth,
Chairman, Surface Transportation Subcommittee Committeee on Commerce, Science, and Transportation, U.S. Senate, Washington, D.C.

Dear Mr. Chairman: I refer to your letter of August 16 requesting my response to three questions for inclusion in the record of your Subcommittee's oversight hearings on the Staggers Rail Act of 1980. My responses are contained in Enclosure A to this letter. I wish also to take this opportunity to comment on some of the testimony presented to your Committee, principally that of the utility and coal interests.

The Adequate Revenue Issue.— At the heart of the utility and coal interests' attacks on Staggers is a disagreement as to the fundamental purpose of the Act, although it is never presented in quite that way. The Congress sought through Staggers (and through the Northeast Rail Services Act of 1981) to establish an economically viable railroad system because only with such a system could the Federal Government be free of the burden of continued subsidy and threatened nationalization. The achievement of revenue adequacy by the railroad industry was recognized as the *sine qua non* to economic viability and is invoked in numerous sections as a guide to Commission action, most notably section 10701a(b)(3):

"In determining whether a rate established by a rail carrier is reasonable for purposes of this section, the Commission *shall recognize* the policy of this title that rail carriers *shall earn* adequate revenues, as established by the Commission under section 10704(a)(2) of this title." (emphasis added)

The attack on the achievement of adequate revenues, and thus upon the purpose of Staggers, takes two forms. First, it is argued that the standard prescribed by the Commission for determining adequate revenues—a return on investment equal to the cost of capital—is erroneous. Second, despite the emphasis in Staggers on the need for the attainment of adequate revenues by the railroads, it is argued that in determining the reasonableness of rates the Commission is obligated to weigh against that need the needs of the shippers.

With respect to the standard for revenue adequacy, the overwhelming weight of authority supports the Commission's determination—the proper standard is a return on investment equal to the current cost of capital. This is precisely the standard the utilities insist upon in state regulatory proceedings to determine their own revenue adequacy. Yet, in testimony before your Committee, they advocate for the railroads the same standards they have advocated unsuccessfully before the Interstate Commerce Commission—standards that are at best only short-run survival tests. Thus, cash flow—the availability of enough cash to get through the next year—would be an indicator of revenue adequacy. The fact that railroad stocks go up reflects the current confidence of the investment community and that would be an indication of revenue adequacy. Measures such as these fall far short of providing the returns envisioned by the Staggers Act (and, of course, the utilities would reject them all as measures of their returns). Staggers contemplates a standard that will permit the railroads over the long run to earn enough to maintain and replace their assets and thereby, and only thereby, stay in business. That is the real test of economic viability and, thus, the correct standard for revenue adequacy.

The stock price approach to revenue adequacy embraced in the testimony of the utilities is especially disingenuous. The extent to which the prices of railroad stocks have risen since Staggers is not a measure of revenue adequacy but, rather, of the stock market's expectations of the effects of deregulation on future rail earnings. If Staggers were amended in the manner sought by those citing stock prices as indices of the railroads' financial health, the price of those stocks would fall through the floor. That would happen because of the market's expectation of the consequences of the rail industry's return to regulation as usual—a return to an environment marked by financially marginal rail operations.

The main thing to be said about the argument that the Staggers Act requires a balancing of the need for revenue adequacy with the needs of shippers, is that it is based on a wholly unwarranted interpretation of the Act. After stating in section 3 that the purpose of the Act "is to provide for the restoration, maintenance and improvement of the physical facilities and financial stability of the rail system of the United States", the Congress went on to list five goals to be pursued in achieving that purpose. They are:

(1) to assist the railroads of the nation in rehabilitating the rail system in order to meet the demands of interstate commerce and the national defense;

(2) to reform Federal regulatory policy so as to preserve a safe, adequate, economical, efficient, and financially stable rail system;

(3) to assist the rail system to remain viable in the private sector of the economy;

(4) to provide a regulatory process that balances the needs of carriers, shippers, and the public; and

(5) to assist in the rehabilitation and financing of the rail system.

It is clear that "the balancing of the needs of the carriers, shippers, and the public" is to occur in the context of four other goals, all of which are aimed at achieving the same purpose—the restoration, maintenance, and improvement of the physical facilities and financial stability of the rail system. In effect, the coal and utility interests would alter the purpose of achieving financial stability by adding the qualification "to the extent it is consistent with the needs of the shippers." It was precisely that kind of balancing by the ICC of the needs of assorted interest groups with the needs of the railroads for revenue which had led the railroads to the brink of disaster by the 1970's—the assumption that somehow the railroad industry, unlike any other industry, could maintain and replace its plant while being held to a level of earnings that did not permit the maintenance and replacement of plant. In urging that the Commission again be required to compromise the needs of the railroads for revenue to accommodate whatever "needs" a shipper might adduce, the coal and utility interests are seeking a return to the days when they could, through regulatory action, extract a subsidy from the railroad stockholders.

The realization that sprouted in the 4-R Act of 1976 and came to full bloom in the Staggers Act was that the users of the railroads, and not the holders of rail securities, ultimately have to pay for a rail system, and the size and quality of that system ought to be determined to the fullest extent possible by economic forces rather than by regulatory forces—by what the users are willing to pay to keep the system in place at an efficient level of operation. The Commission is being faulted in its decisions by the coal and utility interests only because it is attempting to promote the inherent economic efficiencies and balance of interest that result from the application of sound economic principles.

As the Staggers Act recognizes "most transportation within the United States is competitive." Because there are transportation alternatives, those who value rail service the most will pay the most—ultimately up to the "stand alone cost"(which would be the competitive market cost) of the service they need. In its proposed maximum coal rate guidelines, the Commission has struck the balance called for in section 3 of Staggers—the shipper is not being required to pay for costs of service that he does not need. No other balance can be struck between the railroads' need for adequate revenues and the need of shippers except at the price eventually of destroying the private rail system. Any other balancing of the needs of carriers and shippers properly comes into play in a rate proceeding only when a carrier has reached the adequate revenue level, or when issues arise as to whether a revenue inadequate carrier is carrying traffic at unduly low rates, has excess plant, or exhibits other indicia of inefficiency which create costs the rail-dependent shipper should not properly have to bear.

The Coal Rate, Coal Price Issue. --As a corollary to the attack on the adequate revenue standard, the coal and utility interests offered in their testimony a number of charts and tables to contradict data submitted by the Association of American Railroads. They purport to show that rail coal rates are too high and have increased at a disproportionate rate relative to rates on other commodities and relative to increases in the price of coal.

The materials submitted by the utility witness were taken from a paper on coal rates prepared by the Edison Electric Institute. An analysis of that paper is enclosed (Enclosure B).[1] As noted in the enclosure, there are numerous flaws in the Institute's analysis. They include the use of abbreviated time periods (1976-81) which are selected to avoid inclusion of periods when coal prices skyrocketed (1973-75) and rail coal rates were flat (1982-83); the use of non-standard indices; the use of an erroneous inflation deflator; and the erroneous application of cost figures. The National Coal Association submitted graphs comparing coal prices and coal rates which were even more selective as to the period of comparison (1979-83).

A succinct and indisputable comparison of coal prices and rail coal rates—and one which employes no statistical gimmickry—is enclosed herewith (Enclosure C).[1] It shows the movement of coal prices and rail coal rates in constant or "real" dollars (i.e., prices and rates adjusted to remove the effects of inflation) and coal production between 1972 and 1982. The chart shows that rail coal rates declined sharply between 1972 and 1973 and then increased slowly over the next 9 years to the same real dollar level they were at in 1972. In other words, adjusting for inflation, rail coal rates did not increase between 1972 and 1982. And, as I noted in my testimony, since enactment of Staggers the increase in rail coal rates has been only .3 percent in excess of the inflation rate.

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[1] The enclosures are in the committee files.

What about coal prices? The chart shows that between 1973 and 1975 there was more than a 70 percent increase in the real price of coal. This increase was obviously in response to the OPEC oil crisis and far outstripped the increase in the demand for coal and far outstripped any conceivable increase in the cost of coal production. It is clear from the chart that the market would not sustain the peak prices being charged in 1975 and coal prices started declining to a point where by 1982, they were "only" some 35 percent higher (in constant dollars) than they were in 1972. It is this decline from an unsustainable peak that makes any post-1975 comparison so attractive to the coal and utility interests. Any comparison of rail coal rates and coal prices between the period 1975 and 1982 will show a decline in the latter and a rise in the former. To make such a comparison credible, all the coal and utility interests ask is that your Committee place a blotter over the first half of the chart. With the blotter in place, one cannot discern that although rising slowly, rail coal rates have not yet returned to their 1972 level; and that, while falling in recent years, coal prices in 1982 were still 35 percent higher than their 1972 level.

Thank you for the opportunity to offer these further comments for the record. I think it essential that the record be set straight in these matters and will be happy to supply any additional information the Committee may desire.

Sincerely,

William H. Dempsey.

Questions of Senator Pressler and the Answers Thereto

Question 1. Why such a divergence between you and the coal slurry industry answer regarding grain rail transportation rates in wake of slurry pipeline completion?

Answer. The coal slurry industry asserts that the development of coal slurry pipelines will not cause the railroads to lose substantial coal traffic to those pipelines and, hence, will not result in any loss of revenue by the railroads that would have to be recaptured from other traffic. Consequently, they assert that the advent of coal slurry pipelines will have no effect on the rates charged by the railroads for the movement of other commodities. These assertions rest on the assumption that there will be a huge surge in the demand for coal and, thus, no decline in rail coal tonnage. (See letter to Senator Pressler on pp. 69-70 of Senate hearings of September 13 and 16, 1982.)

The divergence between the railroads and the slurry interests on this issue stems from the plain unreasonableness of the assumption that there will be a huge growth in coal production. In making that assumption the slurry promoters rely upon outdated projections of rapid coal growth—projections such as one by the Department of Transportation's (DOT) Coal Transportation Task Force in 1978 predicting an almost doubling of coal production between 1975 and 1985; and one prepared by the Department of Energy (DOE) for Congress in 1979 which projected 1.13 billion tons of coal production by 1985, 1.35 billion tons by 1990 and 1.7 billion tons by 1995.

These projections of four and five years ago have given way to more sober assessments based upon the realities of the day. While there is a consensus that coal will continue to grow as a major source of energy, both domestically and world wide, the expectations of exceptional growth in coal production that were held in the 1970s have largely faded.

One of the principal reasons for the lowering of expectations is the drop in per capita electric consumption in the U.S. The fact that people are using less energy has caused a chain of effects that have drastically altered expectations of coal use.

After four decades of 7 percent annual increases in electric power consumption, energy experts were thrust into unfamiliar territory by the oil embargo of 1973. The initial reactions were to assume that energy consumption patterns would continue virtually unchanged while the sources of energy would adjust to the change in the price of petroleum. In this light, forecasts made in the mid-70s tended to show very sizable increases in coal consumption.

However, altered circumstances have produced drastically diminished expectations. The facts show a slight decline in production in 1981 and another in 1982 and the National Coal Association foresees another decline in 1983. And in reporting on the prospects of future coal growth, NCA President Carl Bagge said, "The coal industry was slow feeling the effects of the recession and it will be slow coming out of it."

Even when the effects of the current world-wide recession are overcome, the long-term projections for coal are a far cry from the roseate claims of the last decade.

National Economic Research Associates has projected an annual growth rate of less than 3 percent. If the annual growth rate continues in this range, it will take nearly 10 years before coal production increases by 250 million tons.

Some of this added production undoubtedly will be consumed via mine-mouth generation which currently handles 15 percent of coal production, up from 6 percent in 1970. Another portion of the 250 million tons, that which moves only short distances, will move by truck transportation. (Trucks now move something less than 10 percent of all coal production.) Still other segments will be carried by barges—the second largest mode of coal transportation—since few of the pipeline routes parallel the waterways.

Thus, the planned pipelines' required diet of 250 million tons clearly exceeds the total new coal traffic which will be available to the railroads in the next decade. If the railroads are faced with no growth, much less losses, in the product which represents 40 percent of its tonnage, one response will most assuredly have to be an increase in the rates on other traffic to the extent competitive circumstances allow. As I stated in a letter to Senator Pressler of October 12, 1982, "While we are not in a position to predict with precision the impact on South Dakota grain rates as a result of construction of coal slurry pipelines, we are in a postion to state with confidence that the impact would be adverse and would be substantial."

Question 2. Do you feel you are providing proper service to rural America? Has it declined any since Staggers?

Answer. As is the case with farming itself, the economies of scale are transforming the nature of rail service in rural areas. The continuation of low density branch lines that could be profitably operated only at non-competitive rate levels do not serve the long-run interest of either the farmer or the railroad. The expanded use of unit trains and the benefits they bring the farmer in quality and price of service will far exceed the costs of any reduction in the ease of access to rail service occasioned by the abandonment of uneconomic lines. As the Ritzville Warehouse Company stated in its testimony before your Committee:

"The Warehouse saved over $350,000 by shipping unit trains compared to the truck/barge rate to the coast. If we would have loaded single cars, the additional freight would have amount to $588,000. Our company has been able to lower our freight charge, thus giving the farmer a higher price for his grain. . . ."

"Ritzville Warehouse Co. has also been able to negotiate a contract rate on wheat and barley from Ritzville. We are cleaning and reloading aluminum cars for destinations on the coast. The loading of the cars has helped the railroad utilize the cars for a backhaul. This savings has been passed back to our members. The contract rate has enabled us to be more competitive for grain this past year. We have put through a larger volume of farm storage grain in our area.

"Ritzville Warehouse supports the Staggers Act allowing the railroads to abandon rail service that is not profitable. The days of the railroad servicing every community is not feasible anymore. The railroad can no longer service one customer on a branch line because of the cost of maintaining the track."

As to the second part of your question, we believe the quality of rail service to rural America has improved since the Staggers Act because of the marketing innovations which the Act encourages. While there has been a decline in the miles of track in service since 1980, that decline is not attributable to Staggers because that Act did not effect any substantive change in the abandonment process. The post-1980 decline is but a continuation of a long-term trend that is fueled by factors such as the vast increase in on-farm storage, the use of large capacity 18-wheel trucks for farm-to-elevator movements of grain, the growth of sub-terminals, and the offering of unit-train service. In the four years between the enactment of the 4-R Act of 1976 and the Staggers Act, the amount of track abandoned averaged 2526 miles per year. In the 1981-82 period the amount increased only slightly to an average of 2677 miles per year (excluding Conrail which was granted a special abandonment authority under the Northeast Rail Services Act of 1981). In that two-year period, the railroads also continued their capital expenditures at levels in excess of their earnings. Much of that investment would directly benefit the producers from farm products.

Question 3. If you, in effect, "cross-subsidize" between coal and grain transportation prices why would it not be possible to do more of the same for rural and urban areas—or I should say areas with heavy traffic and those with lighter traffic? I know there is some of that still going on, but it is at an ever-decreasing rate.

Answer. The existence of a "cross-subsidization" between coal and grain or between coal and any other commodity is a fiction nourished by the coal and electric utility interests. They argue that any commodity that moves at a rate which does not cover both the variable and fixed costs allocable to it is being subsidized by traffic that is moving at rates in excess of the variable and fixed costs allocable to it.

That argument is demonstrably wrong. It is also rather absurd to assume that an industry with woefully inadequate revenues is not attempting to maximize its revenue to the extent possible.

As a general rule, the traffic moving at a relatively high revenue to varible cost ratio is relatively more dependent upon rail service than the traffic moving at a relatively low revenue to variable cost ratio. As long as the rate on the latter exceeds the variable cost of its movement it is making some contribution to the fixed costs of the railroad. The higher rated traffic benefits to the extent of that contribution because otherwise its rates would have to be raised even higher. Rather than a subsidy moving from the higher to the lower rated traffic, a benefit moves from the lower to the higher rated traffic.

The Staggers Act prescribes a minimum rate level based on "going concern value." A subsidy could exist between two different movements only if traffic were moving at a rate that did not contribute to "going concern value." No railroad would willingly carry traffic at such a level. Prior to the Staggers Act it was not unusual for the railroads to be compelled to hold rates on certain commodities below competitive levels and, in some cases, below going concern value levels in order to favor a producer or a consumer, or a state or region. To that extent the ICC or the state regulatory agencies were creating cross subsidies through regulatory action. The minimum rate and regulatory threshold provisions of Staggers have eliminated that practice.

Senator **Danforth**. Thank you very much.

Mr. Snow.

Mr. **Snow**. Thank you, Senator. I am with CSX Corp., the rail holding company Senator Exon referred to earlier, and I will come to his question about our proposed acquisition of Texas Gas.

Let me just say briefly that my company shares the general sentiment of the other railroads that the Staggers Act has been a success. It is moving the industry in the right direction. It is addressing the problems that underlay the considerations of the legislation itself back in 1979 and 1980. It is having a profound effect upon the structure and the performance of the industry, and the effects are beneficial.

I have no hesitancy in saying that the industry today is more competitive, it is more market responsive, and it is more innovative than it was 36 months ago.

The results on adequate revenue are certainly disappointing. As Mr. Dempsey has said, we have not made any dramatic breakthroughs on adequate revenue levels, but I think we are pointing in the right direction and the significant thing to point to is the fact that we have weathered the most significant recession in 40 years without a sea of red ink that otherwise could have been anticipated.

So by and large we see the act as working well and accomplishing its basic objectives.

Senator Exon, you asked about our acquisition of Texas Gas and how a so-called revenue inadequate railroad could afford a billion dollars—you said $1.8 billion; it is really $1.08 billion—to acquire Texas Gas. This is largely a self-financing transaction. That is, it is being purchased from the cash flow which will be generated by the transaction itself.

And from the point of view of transportation, I think it promises some fine things for the future, in that one of the subsidiaries of Texas Gas is a barge line and we will have an opportunity to take to the Interstate Commerce Commission an application case for a railroad to own a barge line and make available to the shipping public the one-stop shopping advantages which we think that transaction would offer.

On coal rates, let me just briefly say that since the Staggers Act the Chessie System Railroads, one of our subsidiaries, has taken only one increase under the revenue enhancement provisions, the flexibility provisions of the act, and that only on domestic coal and only for 3 percent.

At the same time, they have entered into any number of contracts, typically at lower rates, and I should say have put in a 20 percent reduction on export coal moving over the new coal piers at Baltimore and Newport News. Seaboard Coast Line Railroad has put into effect a 22-percent reduction on single car movements out of Tennessee and eastern Kentucky.

And the net result of all of that is that today, on a constant dollar basis, coal is moving on the Chessie System Railroads and Seaboard System Railroads at a lower rate in real dollar terms than it did prior to Staggers.

[The statement follows:]

STATEMENT OF JOHN W. SNOW, SENIOR VICE PRESIDENT, CORPORATE SERVICES, CSX CORP.

Mr. Chairman, my name is John W. Snow. I am Senior Vice President—Corporate Services of the CSX Corporation, the parent company of the Chessie System Railroads and the Seaboard System Railroad. Our two railroad subsidiaries, which produce 92 percent of CSX's revenues, operate on 27,000 miles of track, serve 22 States, and have approximately 57,000 employees. Both our railroads strongly supported passage of the Staggers Act in 1980, and it is a pleasure to appear before your Subcommittee today.

It is now nearly three years since the enactment of the Staggers Act. These hearings to review the progress that has been made toward accomplishing the goals of that act– a more competitive, market oriented, private sector industry, capable of earning adequate revenues—are very timely. Speaking for railroads which were an active participant in the efforts to bring about the deregulation of the rail industry, I can say that the report we have to make to you today is a good one. The railroad industry is stronger, more innovative, more responsive to shipper needs, and more competitive. It has weathered the most serious recession in 40 years without dire consequences—a remarkable feat in itself. The forebodings of those who opposed deregulation on the grounds that the railroads would return to the monopolistic ways of the 19th century have been proven unfounded. As the Congress wisely foresaw, the forces of free market competition—which did not exist when the Hepburn Act was passed in 1887—have worked as they should. The basic Congressional findings underlying the Act—that most transportation within the United States is competitive and that reform of rail regulation would improve the industry's performance—have been confirmed by the experience of the past several years. The Staggers Act is clearly a great success story.

Mr. Dempsey has given you an overview of the results of the Staggers Act from the perspective of the entire industry. I would like to supplement his testimony on three issues. Your letter inviting CSX to testify specifically asked for our comments on the controversy over cancellation of joint routes and joint rates and reciprocal switching charges, and our proposed acquisition of Texas Gas. And because the CSX railroads are large carriers of coal in the East, I would like to give you a report on the beneficial effects the Staggers Act—and particularly its contract authority provisions—have had on coal rates.

Acquisition of Nonrail Assets: CSX presently engaged in the acquisition of Texas Gas Corporation. The Committee is interested in this transaction and how it might impact our railroad subsidiaries. The short answer is that this acquisition will not in any way negatively impact our rail subsidiaries and, in fact, by stabilizing earnings and by allowing for positive tax benefits, will significantly benefit CSX and all its subsidiaries.

Texas Gas is a well run company with a long history of stable earnings and a low debt ratio. CSX is spending approximately one billion dollars for Texas Gas, but essentially our purchase relies upon the assets and earnings of Texas Gas to support increased borrowing and upon CSX cash reserves that exist in great part because of recent sales of nonrail assets—the sale of our four Florida newspapers and two television interests and the transaction with MCI to allow the laying of fiber optic cable. This is not the case of a large rail corporation buying a weak nonrail entity. Our purchase of Texas Gas relied for the most part of Texas Gas' own strength, and the profits we made from the sale of nonrail assets.

In fact, the whole CSX family will be strengthened. Earnings per share of the new CSX post merger will be increased on a pro forma basis. One of Texas Gas' subsidiaries is a barge line . . . the subject of much litigation . . . and the purchase of this barge line, coupled with our rail operations, will offer the attractive prospect of one stop shopping to our customers. One of our existing subsidiaries has substantial oil and gas holdings. But the merger with Texas Gas will bring new management resources that will allow us to better utilize our existing oil and gas interests. Obviously, the profits from this new strength could be used for rail purposes if appropriate. As a very capital intensive industry, the railroads have a problem with being able to use their depreciation and investment tax credits to the best advantage. Again, our merger will provide the vehicle to assist in this situation. Another advantage brought by the merger is more stable earnings. Like other basic industries, our rail earnings tend to be cyclical. The gas line's earnings are much more stable and will help to flatten out the possible lower points in our earnings and thus enable us to sustain a higher price-earnings multiple.

Finally, although it is our intention to maintain the status of our railroads and Texas Gas as independent but under the general policy guidance of CSX, the merger with Texas Gas will allow for discussion between the various subsidiaries and for the cross fertilization of ideas and management concepts which is so important to a vital and growing industry.

We are confident that our proposed acquisition of Texas Gas will contribute greatly to the overall strength of CSX, including our rail units. But the real key to the success and performance of our rail units remains their ability to earn adequate revenues—to having a fair opportunity to earn their cost capital. Because of the Staggers Act the rail industry is making genuine progress on this score, and therein lies the great hope and promise for the future for the rail industry.

Joint Rates and Routes and Reciprocal Switching: Members of the Subcommittee will recall that one of the most contentious issues for the railraod industry during consideration of the staggers Act was how to deal with uneconomic joint routes and joint rates. Within its overall purpose of reducing regulation and restoring competition to the railroad industry, the Act also provided a mechanism for the cancellation of routes which had no economic justification. The present controversy regarding joint routes and rates, and the allied problem of increased rates for reciprocal switching, springs from the activities of the railroads in seeking to carry out the intent of the Staggers Act.

It is important when looking at individual provisions of the Act, whether market dominance, adequate revenue levels or the exemption authority, that we keep in mind they are each specific parts of a bill with one central purpose—the return of railroads to the free marketplace where they can compete with each other and with other modes as do other businesses. The Staggers Act thus was intended to do away with an old way of doing business in which regulation by the ICC governed almost every aspect of railroads' activities, and often thwarted new initiatives or made efforts to change traditional ways frustrating and futile. The old system of rate bureaus and lengthy adversay proceedings over rates before the ICC was one with which many railroads and shippers had become used to. If not entirely happy with the game, all the players were familiar with the rules.

Since passage of the Staggers Act, we have moved into the new system of the marketplace. The adjustments in joint routes and reciprocal switching charges are part of the process of change. By and large it has been a beneficial change. But the new market-place the Staggers Act created is not entirely free, for the ICC remains as the monitor. It can set limits on the freedom of action of the railroads if they overstep the bounds of fair competition. A discussion of how we arrived at the present situation as regards joint rates and routes will, I think, make it clear that the railroads and the ICC are carrying out the intent of the Staggers Act and that there is enough residual regulatory power remaining to protect shippers from any potential economic harm.

Let me begin with a few definitions. A joint rate is a single price quoted for the transportation of goods over a route involving two or more carriers. It is to be distinguished from a single-line rate, which is the price quoted by a carrier for the transportation of goods solely over its own route. Reciprocal switching is the delivery or the origination by one railroad to or from a plant in switching service of a car of freight to be handled by another railroad at single-line rates. For example, a given plant in the District of Columbia may be served only by the B&O, but the B&O will offer to switch cars into and from that plant for other railroads, such as Conrail. This in effect extends Conrail's single-line rates to that plant.

Reciprocal switching is an arrangement that historically was entered into voluntarily by the concerned railroads. In the example given, the quid pro quo for the the B&O service is that Conrail would open a plant accessible only over the lines of Conrail to B&O through reciprocal switching.

It is important to note, for many years, reciprocal switching charges, which are paid by the carriers, not the shippers, were low. They were maintained at low levels on the theory that the service one carrier provided for another line tended to be balanced out by the other carrier's service—hence the use of the world "reciprocal."

The old Interstate Commerce Act did not require the establishment of reciprocal switching agreements. In contrast, the creation of joint rates and routes by carriers was mandatory. Interstate Commerce law imposed a duty upon the railroads to "establish reasonable through routes . . . and just and reasonable rates" with other railroads (49 U.S.C. Sec. 1 [4]). Section 15(3) of the pre-Staggers Act law empowered the Commission to prescribe such through routes and joint rates when it was deemed to be necessary or desirable in the public interest. The same section also required a carrier proposing the cancellatoin of an existing through-route or joint rate to show that the cancellation was consistent with the public interest.

Over the years, as a result of the requirements imposed on the railroads by the Interstate Commerce Act and by reason of the Commission's stringent interpretations of these obligations, there was a proliferation of joint rates to a point where it became a severe economic burden to the carriers. Indeed, the Congress in considering the passage of the Staggers Act noted:

"Two of the major problems caused by the existing joint rate system are too low rate divisions and a proliferation of uneconomic routes protected by the archaic 'commercial closing' doctrine." H.Rept. No. 96-1430, 96th Cong., 2nd Session (1980)

The commercial closing doctrine had the effect of preventing a railroad from making a single-line rate which was lower than its joint-line rate, even though the single-line route was more efficient. In many cases the Commission had held that the joint-line route could not be "commercially closed" by the higher rate, even though the route was uneconomic.

Even prior to the Staggers Act, however, the Commission began to depart from its rigid standards. For example, in a case with the whimsical title of *Hog Hair, Versailles, Ohio to Etowah, Tenn.*, decided March 21, 1980, the Commission announced that "The fact that rate parity once existed between single and joint line routes does not mandate a finding of unlawfulness when that rate parity is changed by publication of new, lower single-line rates." The Staggers Rail Act continued the carrier's obligation to enter into through routes with each other (49 U.S.C. Sec. 10703) and continued the Commission's authority to prescribe through routes and joint rates (49 U.S.C. Sec. 10705(a)[1]) substantially as they existed under the old Interstate Commerce Act. However, responding to the Staggers Act mandate to increase competition, the Commission has quite properly refused to interfere in joint rate cancellations where they reflected the advantages one carrier might have over another, such as a cheaper or more efficient single-line route. As the Commission recently observed, these cancellations "are changes the Staggers Act encourages, as they ultimately produce a more efficient and competitive industry." (Ex Parte No. 445, *Standards for Intramodal Rail Competition,* decided July 7, 1983.)

The Commission's attitude toward the cancellation of uneconomic joint routes should be welcomed as it will lead to a more efficient rail network. This is made clear by a simple reading of the standards which the Commission must consider under the Staggers Act in determining whether cancellation of a through route or a joint rate is in the public interest. These standards are listed in Sec. 10705(e) of the Interstate Commerce Act. It provides that the Commission, in determining whether a cancellation is consistent with the public interest, shall:

(1) Compare the distance traveled and the average transportation time and expense required using (a) the through route, and (b) alternative routes, between the places served by the through route;

(2) Consider any reduction in energy consumption that may result from cancellation; and

(3) Consider the overall impact of cancellation on the shippers and carriers that are affected by it.

No one can seriously quarrel with the cancellation of a route which is, in terms of energy consumption, circuity, congestion, grades, or other operating factors, more costly than the route that the carrier will retain. The cancellation of these inefficient joint routes leads to better utilization of the railroad's plant, energy savings, and ultimately toward the goal of revenue adequacy for the industry.

As the industry has begun to take advantage of its new regulatory freedom, it was to be expected that there would be situations where carriers, in their zeal to realize greater efficiencies and attract traffic, might cause concern among the shipping public because of numerous and widespread joint rate cancellations. However, as long as these rate cancellations result in the elimination of inefficient, circuitous and energy-wasting joint routes in favor of less costly single-line operation, both the interest of the shipping public and the railroads are served. On the other hand, if the joint routes subject to cancellation are more efficient than single-line routes, the Commission must suspend the cancellation or face court reversal of its decision.

Perhaps the most controversial area of cancellation has occurred with respect to reciprocal switching practices. As I stated, reciprocal switching is a practice that the railroads voluntarily entered into at charges which were frequently below cost, on the assumption that there would be a *quid pro quo* in terms of reciprocal switching by other carriers, either in the same switching district or in a different city. It was natural that, given the new regulatory freedom and the impetus to cancel uneconomic joint routes, the carriers would also examine their reciprocal switching services and charges to raise those charges to levels that were compensatory and to eliminate them where adequate service was otherwise available. In fact, the Congress, in the realization that there could be possible abuses of this new freedom, included as a part of the Staggers Act a new section which empowered the Commission to require rail carriers "to enter into reciprocal switching agreements where it finds such agreements to be practicable and in the public interest or where such agreements are necessary to provide competitive rail service (49 U.S.C. Sec. 11103[c] [1]). The Commission has used this new section to require carriers to enter into reciprocal switching agreements. (Finance Docket No. 29802, *Delaware and Hudson Railway Co. v. Consolidated Rail Corp.—Reciprocal Switching Agreement,* decided December 10, 1982)

Also, while the Commission has yet to prescribe the level of reciprocal switching charges, it is empowered to do so by Sec. 11103. In this connection, there has been a great deal of shipper concern expressed over the recent increases in reciprocal switching charges but, as I have pointed out, in the past these charges were noncompensatory, and it was to be expected that the railroads would increase them to levels which covered their cost, plus a reasonable profit. I believe that in an appropriate case, the Commission will set forth standards for determining the maximum reasonable level of reciprocal switching charges on a basis that encourages voluntary reciprocal switching arrangements.

In any case, the Commission now has full powers to deal with the joint rate/reciprocal switching controversy. New Section 11103, which authorizes the Commission to require reciprocal switching agreements, and Section 10705(e), which empowers the Commission to suspend joint rate cancellations not meeting public interest standards, provide more than adequate protection to the shipping public and to rail carriers from any abuses. These are more than adequate restraints on the privilege the railroads now enjoy to promote greater efficiency through the withdrawal of uneconomic and unnecessary joint rates or reciprocal switching services.

Furthermore, the Commission in denying the National Industrial Traffic League's request for a rulemaking proceeding on joint rates, through routes and reciprocal switching in Ex Parte No. 445, announced that it had initiated an industry-wide study of the joint rate/reciprocal switching cancellations. It stated that "The study will be based on an in-depth analysis of the causes and effects of these carrier actions. It will be designed to: (1) Assess the impact of these changes on individual shippers and the system as a whole; and (2) Analyze them in the light of the policies and provisions of the statute." It noted that the results of the study would be useful in connection with these oversight hearings on the Staggers Act and also to determine any need for further action on the Commission's part.

In addition, there is a proceeding now underway before the Commission in which it is examining joint rate and reciprocal switching cancellations at the behest of The Chlorine Institute and other shipper groups. (Docket No. 39176, *The Chlorine Institute, Inc., v. The Atchison, Topeka & Santa Fe Railway Co., et al.)* There is also a current proceeding in which the Maryland Port Authority is challenging the level of reciprocal switching rates imposed by Conrail. From this proceeding could come the standards under which the level of maximum reciprocal switching charges will be established.

Thus the Commission has adequate power to cure any problems which may occur as the railroads act to bring about a more rational and efficient rail network producing adequate revenues for railroads and reasonable rates for shippers.

Coal Rates: In his testimony, Bill Dempsey has presented an overview of railroad coal rates and their relation to the delivered cost of coal and the cost of transporting other commodities. The experience of the CSX supports that testimony. With 27,000 miles of track and 57,000 employees, the CSX rail system is one of the major coal haulers in the East. We consider ourselves to be very much a part of the coal industry, because coal produces over 30 percent of CSX's revenues.

Despite the seemingly adversary relationship between railroads and the coal shippers and the utilities which may appear in the course of the debate over the Staggers Act and coal slurry pipelines, they are among our best customers, producing traffic without which we could not long survive with any level of return on investment. If the coal is not produced and purchased, it isn't shipped. You have heard much about the so-called captive shipper. Well, our railroads are in sense captive to one commodity, coal.

Let me review some figures which will give you a clear sense of the importance of coal traffic to the CSX railroads. In 1982, the Chessie carried nearly 96 million tons of coal which originated at points served on its lines. Of this amount, 30 million tons was for the export market. If we include coal received from other railroads onto Chessie lines, total coal handled was 224 million tons. Coal is the largest single commodity handled by the Chessie, comprising 54 percent of total traffic in 1982. One out of every two carloads originated on Chessie is a carload of coal.

The story for Seaboard is much the same; while the tonnages may be smaller, the importance of coal to commodity mix of Seaboard is just as great. Coal originated on Seaboard in 1982 totalled 64.1 million tons, or 25 percent of all cars originated. Including received as well as originated traffic, coal makes up 26 percent of Seaboard's total revenues.

In discussing the effect that the Staggers Act has had on coal rates on the Chessie and Seaboard, it is well to remember that there are four provisions to consider: the cost recovery index, rate flexibility, (about which you will have heard a great deal from coal shippers and utilities), the virtual elimination of traditional rate bureau activities, and the right of railroads to enter into contracts with shippers (about which you may not have heard so much). Taken together, these provisions have given the railroads greater freedom to act without regulatory restraint, but at the same time forced us to respond to the market. Two significant things have happened on Chessie and Seaboard: neither has taken anywhere near the full amount of rate increases which would have been allowed by the cost recovery index and the statutory rate flexibility and both have entered into contracts with an increasing number of shippers. The result has been that the Staggers Act is being used in a way which reduces, rather than raises, the rates for coal carried by the railroads.

Carriers are now permitted to recover inflationary cost increases on a quarterly basis. The cost recovery provisions of the Staggers Act outline the methodology for calculating these increases. The first increase in coal rates using the cost recovery index was in June, 1981. From that time until the present, a combined increase of 22.6 percent has been authorized on coal rates. In addition, the rate flexibility provisions authorized increases over and above the cost recovery increase. To date, railroads could have raised rates an additional 18 percent beyond the cost recovery increases. Because of market constraints, the Chessie has taken only a 3 percent increase on domestic shipments in 1981. The Seaboard in 1981 applied a 3 percent increase to all coal traffic and in 1982 took another 3 percent increase on some singleline traffic movements. However, some coal rates were actually sharply decreased in 1982. Rates from Eastern Kentucky and some Tennessee mines for coal going to CSX destinations in the North and East were cut by 20 percent. This reduction was a direct response to competition from another railroad. So the increases were far less than the theoretical maximum of 18 percent which would have been allowed by the Staggers Act. And it is particularly significant in view of the fears expressed about what will happen to rates for export coal under the proposed exemption from regulation, that Chessie took none of the allowed increase on export coal rates.

If we combine the increases authorized by the Staggers Act under both the cost recovery and rate flexiblity provisions, the railroads could have increased rates by 46 percent on a compounded basis since October, 1980. On an annual basis, this would have meant an authorized increase of 15.8 percent a year. But on the Chessie System rates for the transportation of coal have resulted in increases of only slightly more than half the authorized increases. From June, 1981, to the present time, coal rates on the Chessie have been increased on a compounded basis by 24.8 percent or 9 percent on an annualized basis. In similar fashion, the Seaboard has used only a portion of the rate flexibility increase it could have taken. In 1982, for example, while the combined authorized increases would have allowed a 10.7 percent rise in rates, published tariffs were only 7.2 percent above 1981. If we included rates negotiated under contracts the overall rate increases for all coal shipments would have been much lower.

The figures I have cited relate to the published tariffs for coal. The increased use of contracts by both Seaboard and Chessie is resulting in coal rates which for the most part are lower than the published tariffs. The rate flexibility and cost recovery provisions have not given the railroads the ability to act unilaterally. They have given both railroads and their shippers the incentive to meet in the marketplace and to negotiate contracts. There are genuine economic incentives for both railroads and shippers to enter into these contracts—for railroads, they offer assured volumes of traffic and revenues, encourage the efficient use of equipment in unit trains, and allow us to plan our equipment acquisitions and capital expenditures; for shippers, contracts bring about lower rates through better equipment utilization and the use of shipper-owned equipment, and they also assure stability of rates and service.

For coal shippers on both Chessie and Seaboard, the use of contracts is steadily increasing. Seaboard currently has 24 contracts in place which account for approximately 22.5 million tons annually or 35% of all originate traffic. In addition, Seaboard participates in 14 contracts in combination with the Chessie. Even beyond the reduced rates offered under these contracts, the Seaboard has also limited its ability to take revenue adequacy increases on the majority of its signed contracts. As a result, Seaboard is now transporting substantial volumes of coal at rates lower than those that were in force prior to the Staggers Act (on a constant dollar basis).

The Chessie System has already concluded contracts covering the annual movement of 39 million tons of coal. It is presently negotiating with customers for an additional 61 contracts for the movement of 21 million tons of coal.

So it can be seen that larger and larger volumes of coal are being covered by contracts, with the benefits they bring to both railroads and to shippers. Let me give you several examples of what these contracts can mean. The Chessie and Seaboard have joined in an agreement with Virginia Electric and Power Company (Vepco) that will save the utility up to $7 million a year. By a combination of published tariffs and contracts, Chessie has dramatically reduced roal rates to privately owned coal export piers in Newport News. Rates to these piers have been lowered by almost 20 percent. Since published export rates have only been increased a total of 21.3 percent since 1980, Chessie has virtually reduced export rates to these private piers to a pre-Staggers level. And Seaboard has recently announced a contract with a State-owned utility in South Carolina which will reduce that rate from $14.19 a ton to $11.80 a ton. The new rate was made possible by the use of a new type of all aluminum hopper car to be purchased by the utility. Using the contract authority, the railroad, the car supplier, and the utility were able to work together to use new technology to bring about a lower rate. These are but a few examples among many which would demonstrate that the regulatory freedom of the Staggers Act has allowed railroads to work with their shippers to develop new and better service.

Mr. Chairman, at the beginning of my statment I said that I thought the railroads, and particularly the CSX railraods, Seaboard and Chessie, had a good report to make to the Congress on the results of the Staggers Act. I think the figures that I have given tell the tale. If these hearings do nothing else, they will have focused attention on what has really happened in railroad transportation and dispelled some of the mythical fears of what might happen. The Staggers Act enabled the railroads to operate free from some of the artificial restraints of the past. But a law passed by Congress did not change the laws of economics. Theoretical pricing freedom has been limited by what the market would actually bear. We have been able to come through the worst recession in recent years in reasonably good financial shape and we have been able to maintain our railroads in excellent condition. But this has come about not through some imagined ability to extort monopoly prices, but through the opportunity to deal realistically with our customers and to make our own pricing and service decisions. I think it is clear that the Staggers Act is accomplishing the purpose that Congress intended whtn it passed this historic law in 1980.

Senator DANFORTH. Thank you very much.

Mr. Boyce.

Mr. BOYCE. Thank you, Mr. Chairman.

I would like to submit for the record the testimony of Mr. Richard Grayson, our vice chairman. He is out of the country and cannot be here today, and I would like to summarize very briefly his remarks.

We were asked to testify on two subjects: One, the purchase of nonrail assets by companies which own railroads; the second one, the cancellation of railroad routings.

I suspect that the first subject, the purchase of nonrail assets, was occasioned by our recent acquisition of a controlling interest in the El Paso Co. Our strategy is really a very simple one. We believe in strength through diversification, and we think that to the extent that the entire company becomes stronger the railroad naturally benefits by being a part of that family.

Railroading, as we all know, is a very cyclical business. We have to respond to the transportation needs of the industries we serve. We do not create a demand for automobiles or grain or houses or anything else. We respond to the cycles of those industries. And if our railroad were not part of a corporate family that included members with more steady sources of income, it would not be nearly as strong as it is today.

What about the Burlington Northern Railroad, owned by Burlington Northern, Inc., the holding company? What has happened to it and what will happen to it as a result of our investment in the El Paso Co.? We think we have been very clear about our intentions regarding our rail operations. For example, in a recent letter to Congressman Florio of New Jersey our chairman, Mr. Richard Bressler, said:

"The Burlington Northern Railroad has never been in stronger physical condition. Far and away the largest share of the capital in our company has been and will continue to be invested in the railroad."

And in a recent communication to employees, Mr. Walter Drexel, president of the railroad, has said:

> No one is going to let the railroad be anything but a first-class property. We do this not out of sentiment, but because we believe we can earn a good return on this investment and because we and the holding company believe that the Burlington Northern Railroad has a strong future.

Now, these are very strong words, and obviously you and the public generally are going to judge us not on what we say but on what we do, and I think that is right. Here is what we have done:

In the 2-year period prior to the formation of the holding company—and I am talking about 1979 and 1980—Burlington Northern Railroad invested a little under $900 million in its railroad track and roadbed. In the 2-year period since the holding company was formed, 1981 and 1982, these investments have totaled $1.1 billion, an increase since the holding company was formed of railroad investment of over 22 percent.

In 1982, 80 percent of Burlington Northern's capital funds were committed to improving the railroad. The total dollars spent were more than any railroad in the country, and in the face of a significant decline in business Burlington Northern was the only major railroad in the country to maintain its original capital spending plan. In 1983 we expect that these capital expenses will be up again more than 20 percent.

This strong financial commitment to our rail operations simply would not have been possible—and I want to emphasize that * * * I am not talking about desirable or philosophically consistent * * * I am saying it would not have been possible if we had not moved aggressively in recent years to diversify our sources of income. During a severe decline in rail traffic, we were actually able to increase our maintenance and capital expenditure program for the track structure.

Strength through diversity, a very simple concept, and you can see how it is being applied today to the Burlington Northern Railroad.

The other topic that we were asked to discuss was cancellation of rail routings. I will not go into that in great detail. It is in the prepared testimony and I will be glad to respond to any questions on that subject.

Thank you.

[The statement follows:]

STATEMENT OF RICHARD C. GRAYSON, VICE CHAIRMAN, BURLINGTON NORTHERN, INC.

My name is Richard C. Grayson and I am currently Vice Chairman of Burlington Northern Inc., a transportation and natural resources company headquartered in Seattle.

I appreciate the opportunity to respond to your request for testimony concerning two specific questions:

1. Purchases of non-rail assets by companies which own railroads
2. Cancellations of railroad routings

I will address these items in order.

I suspect that we were asked to talk about purchases of non-rail assets because of Burlington Northern's recent acquisition of a controlling interest in the El Paso Company. I would like to explain our reasons for this acquisition and how we see it affecting our rail operations.

Our strategy is really a very simple one—we want to strengthen our company through diversification. To the extent that the entire company becomes stronger, the railroad naturally benefits by being a part of that family.

Railroading is a very cyclical business. We must respond to the transportation needs of the industries we serve. As such, we are subject to the fluctuating world grain markets, the rises and falls in housing construction and the changing fortunes of the automobile industry, just to mention a few. If our railroad were not part of a corporate family that included members with more steady sources of income, it would not be nearly as strong as it is today.

But let me be more specific about the reasons for our investment in The El Paso Company and what it means for the future. In looking to expand our natural resource businesses, we examined a number of companies in that field. The El Paso Company best met our investment criteria. El Paso is a prominent integrated energy company focusing on natural gas exploration, production and transmission. It owns substantial oil and gas reserves and controls extensive undeveloped acreage in high potential areas. In addition, El Paso is and should continue to be the low cost supplier of natural gas to a large established California market. We believe that El Paso's competitive strength will result in steadily improving financial performance.

The El Paso Company and Burlington Northern also complement each other in a number of fundamental ways. Burlington Northern management people have experience in the transportation and energy fields and are confortable working in the kind of highly regulated environment that accompanies natural gas production and transmission. El Paso's natural gas pipeline is a transportation system that is as well situated in its market as Burlington Northern Railroad is in the market it serves. In short, we think El Paso and Burlington Northern make a good fit. Unlike some other corporate acquisitions in recent years, we were able to acquire our interest in The El Paso Company without incurring any long-term debt. In addition, the operating results of The El Paso Company are expected to have a favorable impact on our profits from the beginning.

But what about the Burlington Northern Railroad? Has its future changed as a result of our investment in the El Paso Company?

We have been very clear about our intentions regarding our rail operations. In a recent letter to Congressman James Florio of New Jersey, our chairman, Mr. Richard Bressler, said: "The Burlington Northern Railroad has never been in stronger physical condition . . . Far and away the largest share of the capital in our company has been and will continue to be invested in the railroad."

In recent communications to employees, Mr. Walter Drexel, president and chief operatng officer of the Burlington Northern Railroad has said, "No one is going to let the railroad be anything but a first class property . . . We do this not out of sentiment, but because we believe we can earn a good return on this investment and because we—and the holding company—believe that the Burlington Northern Railroad has a very strong future."

These are strong words. Ultimately, we will be judged on the basis of what we do, not what we say. That's as it should be, and here's what we have done. In the two year period prior to the formation of the holding company (1979 and 1980) Burlington Northern Railroad invested a little under $900 million dollars in its railroad track and roadbed, including the expense of repairs and renewals of track structure. In the two year period since the holding company was formed (1981 and 1982) these investments totaled $1.1 billion dollars, an increase of over 22 percent.

In 1982, 80 percent of Burlington Northern's capital funds were committed to improving our railroad. The total dollars spent were more than any railroad in the country. In the face of a significant decline in business, Burlington Northern was the only major railroad in the country to maintain its original capital spending plan.

In 1983, we expect that Burlington Northern Railroad will spend almost 20 percent more than last year on capital improvement and, once again, will spend more than any other railroad in the country. The railroad's capital spending program is targeted for $465 million, but total capital spending and maintenance-of-way expenses are scheduled to be $1.1 billion.

This strong financial commitment to our rail operations simply would not have been possible if we had not moved aggressively in recent years to diversify our sources of income. As you know, the recent recession meant reductions in rail traffic nationwide and Burlington Northern was no exception.

To see what can happen to a company whose railroad operations are not complimented with other sources of income, you have only to look at Burlington Northern's history in the 1970's during periods when rail traffic declined by lesser amounts than we have experienced in just the last two years. Because the company was almost entirely dependent on railroad operations for its earnings, when traffic fell off it was necessary to severely cut back both maintenance and capital expenditure programs. As you can see from the numbers I cited a few moments ago, this did not happen in the last two years.

During a severe decline in rail traffic, we were actually able to increase our maintenance and capital expenditure program for our track structure. Strength through diversity—it's not a new concept, but it's one that we think says a lot about the future of our company, our railroad and the rail industry generally.

I would now like to turn to the other matter we were asked to discuss—cancellation of railroad routings. Unfortunately, this is a subject that has become overgrown with a great deal of misunderstanding.

This Burlington Northern Railroad has cancelled some of its joint routes—that is, its agreements to move freight traffic sequentially with another railroad. It has only done so where BN is capable of handling the traffic without the involvement of a second railroad.

None of our shippers has lost access to any markets, because we are eliminating only those multiple-carrier routes which duplicate single line BN routings. A good illustration of the changes we are bringing about can be seen in freight movements through the Twin Cities to Chicago. For example, a car of lumber that we hauled from a mill on our railroad in the state of Montana frequently would be routed via Burlington Northern to the Twin Cities where it would be switched and transferred to one of three other railroads with routes to Chicago. This, of course, is a corridor that BN already serves.

In addition to the extra cost and the inefficiency of switching and transferring the car to one of our competitors, we frequently have had to bear the cost of accepting the empty car at its destination—according to car service rules—and returning it the entire distance on our own line, having received only a portion of the revenue.

We can find no benefits to our shippers in this practice. There certainly are none for us. What housing contractor would construct the first floor of a house and allow a competitor to come in and build the second story, and then be required to clean up when the competitor finished?

If a shipper truly desires to ship in this segmented fashion, he can do so by shipping under the individual rates of each railroad on the route. We have never precluded this option—but the shipper would pay a higher rate to use the higher cost routing.

A related issue if the cancellation of reciprocal switching agreements. Under such agreements, each railroad serving a major terminal area agrees to switch cars to and from shippers on its line to other railroads in that terminal area. This means that a flour mill located on Burlington Northern tracks in Minneapolis can send cars to, or receive them from, the other railroads serving that city. Burlington Northern has not cancelled any of these agreements against the wishes of its shippers. We believe that reciprocal switching is a genuinely competitive practice and we support it.

In summary, I would like to say that the Staggers Act is working and is beginning the lengthy task of restoring financial health to the railroad industry. But we still have a long way to go. Last year the Burlington Northern Railroad's return on investment was only 4.4 percent and that was one of the highest returns we have earned in recent years. Compared with normal industrial returns in the neighborhood of 15 percent, the rail industry is still far behind in its attempt to be competitive in the capital markets.

I appreciate the chance to appear and would be happy to respond to any questions you might have.

Senator DANFORTH. Thank you, sir.

Mr. Marshall.

Mr. MARSHALL. Thank you.

I would like to talk about three things that have happened since Conrail's testimony was submitted. These things occurred during the last week.

First of all, Conrail has announced a reduction in its export coal rates to take effect August 5. Trainload rates from West Virginia and from western Pennsylvania will be reduced to $13.40 a ton. That will bring us $2 a ton below the other carriers from West Virginia. We believe it will make new markets for West Virginia coal and Pennsylvania coal. By bringing West Virginia coal into Philadelphia, that coal can be mixed with Pennsylvania coal and we can create geographic competition between Pennsylvania and the coal mines to the south.

These are rate changes that would not have been possible had we the expectation of continued regulation, because regulation tends to freeze rates. Once reductions are made, they tend to become permanent.

It also tends to regulate the relationship between different areas. We are destroying the historic relationship between mines on our lines, so that all of them can produce more coal for export.

The second thing that has happened is that we have reached the first agreement with respect to boxcar deregulation with a major western carrier. This agreement will encourage the efficient use of boxcars and help squeeze out some costs.

Third, and I think most important, on Friday we reached agreement with five short lines that operate in New Jersey, New York, and Pennsylvania. These short lines make up the Delaware Otsego system. They supply boxcars, as do many other short lines. And the agreement we made with them will encourage the efficient use of cars, discourage the empty movement of cars, and I think most important, encourage price reductions to shippers.

One of the things that the agreement incorporates is a low system of rates quoted by Conrail to the short lines, so that the short lines can go out and sell our service to their customers. It is something that they think is beneficial and something that we feel is beneficial. We hope that there will be other agreements that will follow in the months ahead.

One of the things about the Staggers Act and the boxcar deregulation and export coal deregulation which is most important is the reduction of costs. Much of the testimony here this morning has focused on rates and prices, but the thing the railroads must do if they are to succeed is to reduce their costs.

This goes back to Senator Long's concern with efficiency. There has been a lot of inefficiency in the railroad business, and it was put there by the system of regulation which made all rates equal irrespective of market demand and irrespective of the efficiency of various routes.

The thing that deregulation is making possible is the better use of our assets, the reduction of costs, so that we may reduce our prices and passthrough those price reductions to our shippers. One of the things about the agreements that we are working toward with the short lines is that we hope they will be able to reduce their freight rates.

We have heard earlier some questions about a packing company in Green Bay, but the questions were oriented toward what deregulation might mean to the railroad operations of that packing company. The railroads do not stand on their own feet. They depend on their shippers. Unless we can keep those shippers using the railroads by quoting them lower rates, none of us are going to be in the boxcar business.

Conrail has watched its boxcar traffic melt away from nearly 800,000 cars in 1977 to fewer than 300,000 cars last year. There simply will be no more boxcars at the end of the decade unless we can get our costs down and get our prices down.

Trucks last year were authorized to become longer and wider and heavier. That will save them 12 percent of their costs. The railroads must do the same thing. We do not think we can do it without deregulation. We think that deregulation will help us. We are doing our best to make it work.

Thank you.

[The statement follows:]

STATEMENT OF CHARLES N. MARSHALL, VICE PRESIDENT, MARKETING, CONSOLIDATED RAIL CORP.

Conrail welcomes this opportunity to provide testimony in support of the Staggers Rail Act of 1980.

In the two and a half years since the passage of the Staggers Act, Conrail has come back from the brink. In 1980, Conrail lost $244 million on a GAAP basis. In 1982, Conrail earned $175 million ($39 million from operations), and we shortly expect to report earnings from operations substantially above that amount for the first half of 1983. These improvements have occurred while the Nation has faced a massive and sustained recession.

The Staggers Rail Act and the Commission's reasoned application of that Act have been vital to Conrail's turnaround. The Act has increased the responsiveness of rates to market forces and facilitated the reduction of Conrail's costs. Today I should like to explain some of the actions that Conrail has taken under the Staggers Act and the reasons why those actions are beneficial not only to Conrail but also to our shippers and connecting lines.

Before I do that, however, I want to make two stark observations. The first is that the decline of the Northeast has not stopped, as continuing steel mill closings indicate. Between 1980 and 1982, production in the American steel industry declined from 111 million tons to 73 million tons. Between 1980 and 1982, the production of automobiles declined from 6.4 million units to 5.1 million. Most observers agree that these declines have hit the Northeast harder than any other region of the country, and that the greater effect of them is likely to be permanent rather than temporary.

The second observation is that trucking competition becomes ever more effective, particularly following the amendments to the Surface Transportation Act of 1982. That statute and other legislation permit wider, longer, and heavier trucks to utilize a system of roadways encompassing Conrail's service territory. We estimate that truck costs will thereby be reduced, after recent fuel tax increases, by 7 to 12 percent. In the face of these two powerful forces—declining traffic and increasing motor carrier competition—Conrail and other railroads can continue to contribute to our economy only to the extent that the railroads remain flexible. To roll back the clock and reimpose artificial, burdensome, and now discredited regulations would only increase the problems of the rail carriers and the customers they serve.

Let us examine some of the specific actions taken by Conrail under the Staggers Act.

The pro-competitive policies of the Act made possible for the first time the replacement of joint rates with other kinds of rates tailored to cost and market conditions. Conrail used this new freedom both with respect to inter-territorial traffic (between Conrail's territory and the West and South) and intra-territorial traffic. The reasons for the joint rate cancellations are very simple. Under regulation as practiced before the Staggers Act, railroad joint rates were equalized over virtually all routes between any given pair of points. Irrespective of whether a railroad went over the top of the mountains or through a valley, the rates were the same. And unanimous consent of all connecting lines was necessary before any rate could be changed. The result was that railroads did not compete with each other, and they did not compete with the trucks either. Because some of the routes over which the rates applied (such as the one over the top of the mountain) had very high costs, the rates tended to be relatively high. The efficiency, and lower costs, of better routes were not reflected in the rates, and the carriers lost much business unnecessarily to their competitors.

Faced with this problem, Conrail set out in July, 1981, to cancel redundant joint rates between itself and its connections in the West and South. Only the artificial joint rates were cancelled; no routes were closed and the other rates remained. The way Conrail did this was by limiting gateways over which joint rates applied. These actions affected only 7½ percent of all inter-territorial routes and only 14 percent of inter-territorial carloads.

This did not mean that shippers were left with no choice of routing. What it did mean was that the traffic was focused over the more efficient routes. By concentrating the traffic in direct lanes, the trains could be longer, switching could be more efficient, and costs became lower.

Conrail's evidence to the ICC showed that it eliminated an aggregate of 3.2 million car miles every year, and an average of 1.2 days of transit time per affected carload. We estimated that this would produce a net benefit for Conrail of $28 million a year—a substantial part of Conrail's operating profit for 1982. Yet, virtually no shippers suffered an increase in rates.

This action helped us to streamline both the plant and train operations and will contribute to Conrail's profitability in the future, as well as to the efficiency of the railroad industry as a whole.

In April, 1983, the Seventh Circuit Court of Appeals in Chicago remanded the Commission's decision approving these cancellations for the introduction of more evidence. However, the Court approved the cancellations in principle, and we are optimistic that the Commission will affirm most or all of them on remand.

Similarly, in October, 1982, Conrail undertook a program of intra-territorial joint rate cancellations. These, too, were approved by the ICC, and we estimate Conrail net benefits of $5 million a year, with savings of 1.9 million car miles and 128,000 interchanges a year. This action has permitted further efficiencies and illustrates how the Staggers Act is a vital part of the rebuilding of Conrail. Once again, no shipper suffered a rate increase. The intra-territorial rates are now before the United States Court of Appeals for the Sixth Circuit, after some of the rate changes were enjoined by a district judge in Detroit.

The intra-territorial joint rate cancellations are in part a response to the merger movements which have occurred in recent years. Just as the mergers concentrated traffic on single systems, thereby eliminating interchanges and reducing costs, so the intra-territorial cancellations eliminated interchanges and tended to provide the shippers with Conrail single system service between Conrail local points.

Even where joint rates have been cancelled, shippers are free to use combinations of single line rates. There are cases where new combinations of rates filed by our competitors have shifted traffic away from Conrail. This illustrates how competition works when the tools provided by the Staggers Act are employed. In the day and age of pervasive competition, there is no reason to require equalized prices on all railroad routes while barges and truck lines are free to adjust their prices as they please.

A third Staggers Act rate change by Conrail involved grain. Truck competition had been eroding the railroad share of the market from the important grain growing areas in the Midwest. In August, 1981, Conrail replaced its antiquated and outmoded grain tariffs (then totaling about 4,000 pages) with a new and easily comprehended grain tariff of only 39 pages.

The new tariff, which was approved both by the ICC and the Second Circuit Court of Appeals, has caused our rail grain business to flourish. (Indeed, Conrail obtained honorable mention for that tariff in Modern Railroads magazine's Golden Freight Car competition for the year 1981.) The annual benefits are estimated to be $8 million a year.

Because of these changes in the grain rates, Conrail is now able to price in a way that is far more responsive to the market. Conrail can raise and lower its rates in accordance with demand and thereby use its equipment to the best advantage. We installed new rock botton gathering rates on grain moving from country elevators into processing points, and from processing points to the Ohio River in 1982. After these rates went into effect, our domestic grain business increased by 30%, as enormous quanitities were shifted from the highways to the rails. Just a week ago, Conrail slashed its rates through 1984 on export coal from West Virginia and certain Pennsylvania coal fields to encourage the growth of new traffic for Conrail. We could not have risked these rate cuts without deregulation, because the ICC might have forced us to make the rates permanent or expand them to other traffic. As it is, deregulation has enabled us to benefit shippers at a time and place that we have excess capacity. This is a tangible evidence of the benefit to shipppers which pricing freedom, under the Staggers Act, has brought.

Another subject which has received a great deal of attention in the popular press in recent months has been reciprocal switching. Conrail has not concelled any reciprocal switching, but it has raised switching rates. To understand what has been going on, it is necessary to understand a little about what reciprocal switching is.

Reciprocal switching is the price charged by one carrier to another for moving cars to and from industries. Reciprocal switching charges are not generally paid by the shippers and instead are "absorbed" by the line-haul carrier.

For many years, the ICC regulated reciprocal switching charges at very low levels, usually only a fraction of cost. The losses on switching service were expected to be cross-subsidized by profits on line-haul service. Conrail's annual losses on switching services exceeded $5 million in 1982.

As trucking competition increased and as inter-railroad competition increased, profits on line-haul service diminished. There are no longer the means to cross-subsidize terminal service. Conrail believes that the terminals, like any other service in a competitive industry, should stand on their own feet. Accordingly, Conrail raised it prices, producing a net benefit of $8 million a year.

Virtually all of the increased price for reciprocal switching has been paid by other railroads, not by shippers. The problem complained of by some shippers is that other railroads have cancelled some of their switching services. Where this has happened, Conrail has done everything in its power to make alternative arrangements to accommodate its shippers. We have been almost universally successful. In some cases we have developed or retained joint rate arrangements with the connecting railroads. In other cases we are providing allowances to shippers so that can buy switching services from connecting carriers. Although there was a great deal of apprehension among shippers, very few were materially affected by the changes in switching last winter.

As changes in joint rates and switching have occurred under the Staggers Act, we have noticed that there has been a great deal of apprehension about what might happen before the changes were made. But usually after the changes were made we found that most of the parties involved could accommodate the change, and many were even pleased.

Maximum rates are another subject which have been treated broadly in the public press. But the complaints which are aired publicly overlook the great progress which the railroads and their customers have made in settling complaints over maximum rates. Section 229 of the Staggers Act provided a procedure for shippers to complain to the ICC that their existing rates were to high. Conrail was initially a defendant in 248 of these cases.

Of those cases, only 80 are left. Of the 33 cases involving coal where Conrail was the principal defendant, only 9 are now in active litigation, and another 13 are quiescent. In some cases rate reductions have been arranged for shippers by contract; in other cases shippers have agreed to their existing rates (or higher rates), subject to specified guidelines for increases in the future. The process seems to be working well, and we urge the Congress not to tamper with it. After all, if our rates are found to be too high and must be reduced at a time when Conrail is emerging from federal guardianship, where, in a competitive environment, is revenue to come from to make up the shortfall? There simply is no such place, and reduced rates would inevitably result in deterioration of the quality of service. Particularly when one remembers that the litigation over rate reasonableness involves only well-established rates that have been in place for several years, the plea to take away needed rail revenues seems ill-founded.

Another Staggers Act opportunity which has recently presented itself is boxcar deregulation. The boxcar problem is massive overcapacity coupled with a shrinking traffic base. We estimate that the railroads under the regulated system of car-hire are producing a billion miles of unnecessary car movement a year. This wasteful practice costs the carriers an aggregate of over $300 million a year, a substantial part of which can be saved with deregulation.

Attached as Appendices 1 and 2 are two maps. The first shows the empty movements of plain boxcars under regulation. The second shows the dramatic empty movement reductions possible under deregulation. These lower costs will mean lower prices and more boxcar freight. Similarly, Appendix 3 shows how the ICC formula has increased boxcar rental charges as boxcar surpluses have grown. Deregulation will end this vicious cycle.

Some have criticized boxcar deregulation as being "overbroad" when contrasted with such "modest" exemptions as the one previously granted for piggyback. These critics have apparently been unaware of the alarming inroads which trucks and piggyback have already made into the boxcar business. Last year, 16% of the railroads' loaded units were exempt piggyback trailers; only 12% were boxcars. Conrail has suffered a startling falloff in plain boxcar loads, from 796,000 loads in 1977 to only 288,000 last year.

Experience with railroad deregulation has been uniformly good. After deregulation of both piggyback and perishables, prices went down and traffic blossomed. Just so with boxcars, we must shed the hundreds of millions of dollars in annual costs imposed by regulation. If we can, the rates will go down, and we may be able to fend off truck competition. Make no mistake, if we cannot reduce costs and rates, boxcars will go the way of the dodo before the close of the decade.

Conrail is committed to a gradual implementation of deregulation in a way that will not unduly disrupt either shippers or connecting lines. After all, it is our intention to stay in the boxcar business as long as we can, and we cannot do that if we provide commercially unattractive arrangements under deregulation. We have already developed a new pricing approach which ensures that joint rates will continue to be available to our shippers. And we have negotiated over 50 bi-lateral agreements with boxcar owners in the past few years covering terms of car use and rental payments. We expect to be able to arrive at more such mutually acceptable agreements under deregulation.

Conrail has been able to cope with these changes because of the flexibility provided by the Staggers Act and its companion, the Northeast Rail Service Act of 1981. The Conrail financial situation has greatly improved in the past three years, but the health of the Northeastern economy has not. We expect continued declines in many industries, and unless Conrail remains flexible and able to redirect its services to areas where there is need for them, the progress that we have made will quickly be eroded. The kinds of regulations proposed by many opponents of the Staggers Act are exactly the kinds of regulations that brought Penn Central to its knees.

Remember that the width, length and weight of trucks will be dramatically increased. Competitive equity demands that the railroads be allowed to reduce their costs to the lowest possible level. The Staggers Act is what helps make that cost reduction possible.

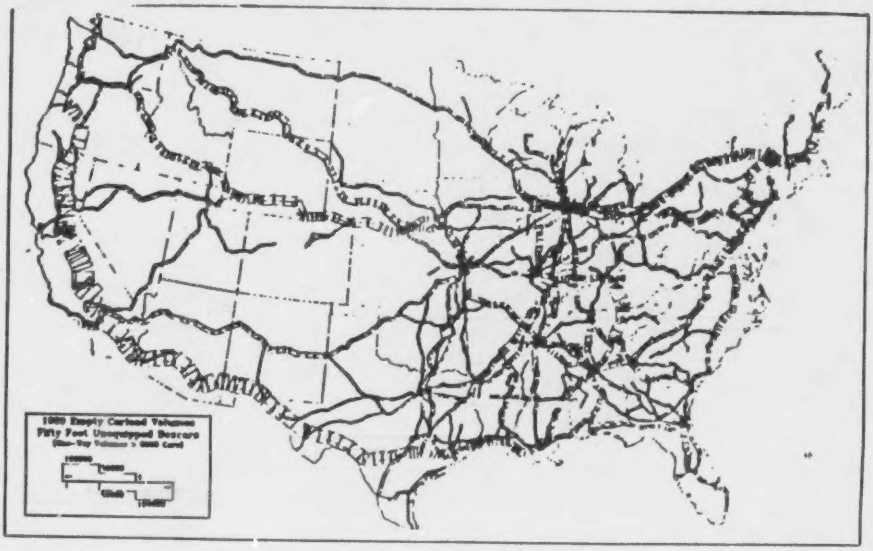
The simple fact is that the railroads cannot compete if they are reregulated. The competing trucks and barge lines are not regulated, and the railroads need every bit of freedom that the Staggers Act gives them.

In conclusion, the Staggers Rail Act is responsible for saving the rail network from financial disaster. Many of the critics of the Act are bemoaning the loss of uniform rates, not because they are directly hurt, but because the loss of those uniform rates actually increases competition between competing shippers. In the few cases where real shipper injury was threatened to occur, Conrail has worked conscientiously to alleviate the problems that might have resulted. We are aware of few shippers who can show actual injury today. And the Staggers Act has provided real benefits by reducing costs for the good of all.

THE PROBLEMS:

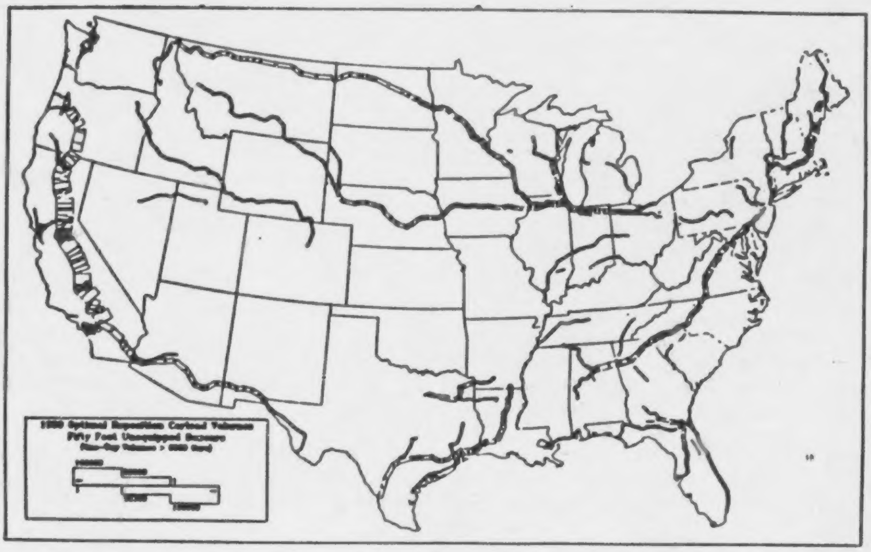
D. COSTLY AND WASTEFUL EMPTY MOVEMENTS HAVE INCREASED

IN 1981, THERE WERE 226 MILLION MORE EMPTY CARMILES THAN IN 1980, DESPITE A DECLINE OF 238 MILLION LOADED CARMILES


Empty Carload Volumes
Fifty Foot Unequipped Boxcars

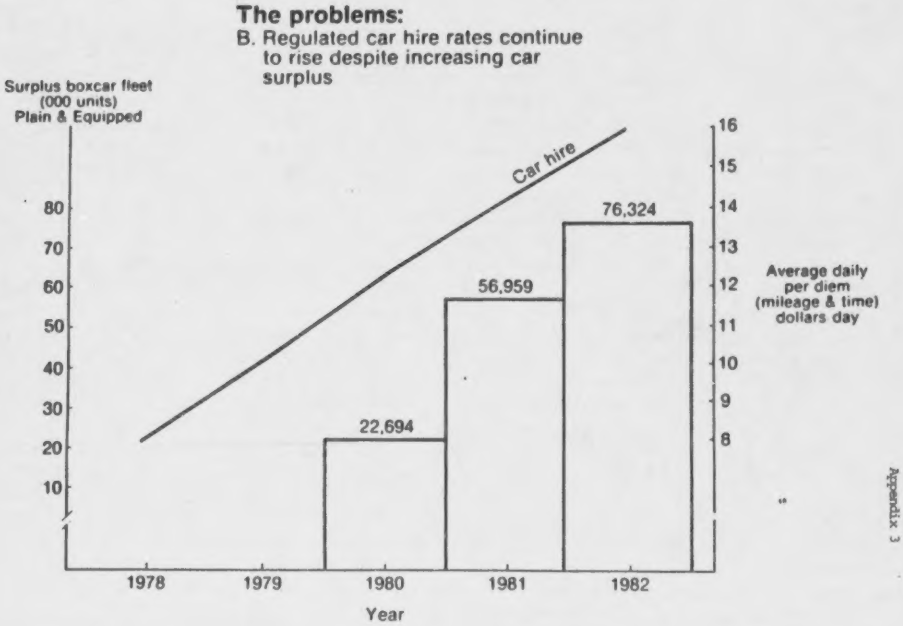
Appendix 1

WITH OPTIMAL REPOSITIONING, EMPTY CARMILES WOULD HAVE BEEN REDUCED BY 1.009 BILLION, OR 73 PERCENT, IN 1981


Optimal Reposition Carload Volumes
Fifty Foot Unequipped Boxcars

Appendix 2

BEST COPY AVAILABLE



The problems:
B. Regulated car hire rates continue to rise despite increasing car surplus

Appendix 3

[The following information was subsequently received for the record:]

QUESTIONS BY SENATOR GORTON AND THE ANSWERS THERETO

Question 1. According to the petitions Conrail has filed at the Commission, Conrail sought these new car hire rules—storage and empty return charges—in order to solve the problems of having empty cars on your lines. But since Conrail is primarily a terminating carrier, won't Conrail always have more empty cars than it can load on its lines?

Answer. Each year Conrail receives approximately 170,000 more boxcars from other carriers than its customers load to other carriers. Thus Conrail will always have a substantial supply of empty boxcars on its lines. The issue is how to utilize boxcars more efficiently and stop empty cars from moving unnecessarily. Because Conrail must now pay rental for every day the cars are in its possession, the excess cars are returned to the owner as quickly as possible regardless of the empty miles involved and regardless of whether the owner has access to nearby empty cars that would not need to be moved great distances.

An example follows to demonstrate the inefficiencies in current practices. Seaboard will supply a Seaboard car to move a load from the South to CR despite the fact that empty Conrail, Boston & Maine, or Maine Central cars which moved to the South under load are available nearby. These CR, B&M, MEC marks are then retrned empty northbound. The Seaboard car is returned empty southbound after it terminates in the North. Empty cars pass each other in opposite directions! A more efficient system would obviously reload the northern cars in the South and the Seaboard cars in the North.

With boxcar deregulation and the optional empty mileage charges, carriers will seek to minimize those empty mileages. In the previous example, Seaboard will prefer to return the Boston and Maine or Conrail car loaded to Conrail rather then load the Seaboard car on which the optional 35¢ empty mileage charge could be assessed if Seaboard requested the car returned. The above changes in boxcar flows can be accomplished by bilateral agreements. Conrail has already reached such agreements with several large and small carriers, including Southern Pacific and Delaware Otsego System. The end result will be fewer empty miles, lower costs and increased competition.

Question 2. What does a Class III railroad have that Conrail wants when car hire negotiations take place? How much traffic does any given Class II railroad produce for Conrail's lines? How many empty Conrail boxcars does any given Class III railroad have on its lies at any time?

Answer. Most Class III carriers have boxcar shippers on their lines. Due to the high costs of boxcars, however, much of this traffic is steadily being lost to motor carriers. Conrail wants to work with the Class III carrier to reduce costs and get the business back. Conrail does not want to jeopardize any carrier's car supply; but we are seeking increased flexibility in the use of empties. We are also encouraging special solicitation arrangements that take advantage of a short line's knowledge of local markets. And with pricing deregulation Class III carriers will have the freedom to change their prices in response to the needs of their own customers.

In 1982, Conrail received 30,432 loads in plain and equipped boxcars which originated on Class III roads, including terminal switch lines. This represents about 8 percent of all received boxcar traffic handled. These 30,432 loads generated to CR revenue of approximately $30 million. These originations range from as few as one car per year to as high as 2,167 cars. Of 120 roads represented: 8 produced over 1,000 cars each, or 37 percent of total; 13 produced over 500 cars each, or 26 percent of total; 37 produced over 100 cars each, or 31 percent of total; 62 produced up to 100 cars each, or 6 percent of total.

Any single Class III carrier will have very few CR cars on its lines.

An examination of a recent one-week sample of Conrail's traffic found that out of 1,470 plain 50 ft. Conrail-owned boxcars loaded on Conrail, only 43 terminated on Class III railroads. An important reason is the fact that Class III railroads which have boxcars bearing their reporting marks have almost always loaded such cars in preference to other railroads' cars.

Question 3. BRAE has asserted in its Petition For Reconsideration, and many short lines agree, that short line railroads will lose their ability to stay in business or at least will lose substantial sums of money if the new rules take effect. What will happen to their boxcars? Won't they be lost to the rail system?

Answer. First, we disagree that boxcar deregulation will cause the bankruptcy of short lines. Many short lines and car lessors have already experienced a significant revenue loss due to traffic diversion to truck. Most short lines also possess a high quality boxcar. As boxcar deregulation begins to generate a national flow and ownership distinctions begin to fade, these higher quality cars will have the greatest demand and highest utilization. The poor quality boxcars, largely owned by the large Class I carriers, will tend to be idled first. Indeed, because Conrail owns few boxcars of its own, Conrail prefers to keep as many short line car suppliers in the market as possible rather than being left to the vagaries of supply from the older fleets of a few Class I lines.

As costs are reduced, short lines and Class I carriers will be able to compete for additional boxcar traffic. In one bilateral agreement Conrail has already signed with a short line, the cost savings generated enabled Conrail to offer freight rates approximately 40 percent below those previously in effect.

There is no question that with the current surplus of boxcars, some car hire rates will fall. In an efficient marketplace, this will always be the result. Conrail has already experienced a sizeable reduction in the return on its investment in boxcars, causing it to scrap over 18,000 Conrail-owned boxcars since 1977. Effective October 1, Conrail has also stated it will reduce car hire prices in CR plain boxcars by 20 percent.

A regulated boxcar cannot compete with deregulated piggyback and increasingly deregulated motor carriers. If the boxcar cannot become more efficient, it is certain that short lines will lose money as the traffic is diverted. And unlike boxcar traffic, piggyback bypasses short lines completely.

It is also important to note that the greatest impact of reduced car hire rentals will not be felt by the short line but, rather, by the car lessors and the private investors. In most of these car leasing arrangements, the short line merely acts as a conduit for passing the car hire receipts back to the lessor and the private investors, many of whom are not directly involved in the railroad industry.

Many short lines point to the 35¢ optional empty mileage charge as the major cause of their reduced earnings. Under deregulation, the car user may assess this charge if the car owner requests their cars be returned. Conrail has stated publicly that our objective is not to charge for empty miles but to reduce empty miles. (Empty movements cost us 47¢ a mile, so movements for only 35¢ a mile in revenue are not appealing.) We have also stated that Conrail will not assess this charge until we and the car owner have first had the opportunity to discuss the possibility of a bilateral agreement. In these agreements, the use of empty mileage charges will be minimized.

Question 4. Since Conrail will always have more empty cars than it needs on its lines, aren't these new rules just an effort to shift some or all of Conrail's expense back to the boxcar owners?

Answer. No. Conrail's objective is not to shift costs, but to lower the overall costs by making boxcar service more efficient. If conrail simply shifts some existing costs back to the car owner, boxcar deregulation permits the car owner to raise its part of the freight rate. To keep the business, Conrail would then have to reduce its freight rate. Thus, cost shifting changes little; avoidance of unnecessary empty handling is the big benefit.

QUESTIONS BY SENATOR MELCHER AND THE ANSWERS THERETO

Question 1. How many serviceable boxcars does Conrail own?

Answer. Conrail owns: 3,409 serviceable plain 50 ft. boxcars, 19,048 serviceable equipped or insulated boxcars.

Question 2. How many boxcars does Conrail load each month?

Answer. Conrail loads each month: 3,500 plain boxcars to Conrail destinations; 4,900 plain boxcars to other railroads; 10,040 equipped or insulated boxcars to Conrail destinations; 11,260 equipped or insulated boxcars to other railroads.

Question 3. Since Conrail loads many more boxcars than it owns, isn't it true that Conrail is vitally dependent on using other railroads' cars—including short line boxcars—to meet shippers' requirements?

Answer. Definitely. As indicated above, even at a low utilization of one trip per month, Conrail owns sufficient equipped boxcars to cover the traffic it originates. In plain boxcars, Conrail's policy has been to own sufficient cars to cover business which originates and terminates on Conrail. (Additional Conrail cars would be useless. For regulation prevents Conrail from moving Conrail empty cars to other railroads, even where those cars could be loaded back to Conrail). For plain boxcar loads to other railroads, our policy has been to utilize existing cars which were loaded inbound to Conrail. For such traffic, we are and will continue to use short line cars as well as other cars. With this approach, we try to minimize empty miles, reduce costs and prices. Over the last four years, Conrail has published over 1,300 reduced, backhaul prices tied to the return of foreign equipment. These reductions generate in excess of $9.0 million in revenue for Conrail and other railroads that would otherwise have been collected by motor carriers. The boxcar exemption will provide the tools for all rail carriers to minimize empty miles and reduce costs, and to compete more effectively with motor carriers for additional boxcar traffic.

Question 4. Why shouldn't Conrail pay a fair economic rent for the use of someone else's boxcars, particularly if it is unwilling to acquire enough cars of its own to meet its shippers' needs?

Answer. Conrail does not object to paying a "fair economic rent". However, in a market where the boxcar competes with deregulated TOFC and increasingly deregulated trucks, the proper or "fair" rent a carrier should pay should be determined by the market not by administrative fiat. Car owners should have high earnings (encouraging carbuildings) when demand is high and low earings (discouraging carbuilding) when demand is low. Our deregulated truck competitors do not try to recover the full cost of their equipment during a recession, yet regulated railroads have their boxcar rates inflated during recession times by a rigid administrative formula for car hire that succeeds only in raising costs, raising rates, and driving business to the trucks.

Current car rental fees are determined by an ICC prescribed formula that adds total boxcar input costs (labor, material, profit, etc.) and divides by the active fleet miles. When demand (car miles) drops, the rental fee increases. As might be expected in a competitive environment, as costs and prices rise the volume of traffic drops, thereby increasing the boxcar surplus and costs. As the volume continues to fall, the car owner receives no rental because the car is idle.

In a deregulated environment, car hire will fluctuate with supply and demand. The newer, higher quality short line cars will support higher rentals than the poor quality cars. In addition, deregulation will permit carriers the unilateral right to change their portion of the freight revenues as another means of improving the return on their assets.

Question 5. Don't the present regulations offer enough flexibility for Conrail? For example, according to the BRAE Petition for Reconsideration, BRAE has a reload agreement with Conrail that gives you up to 11 free days a month for any boxcar that you reload within those days, if a certain number of BRAE boxcars a month are reloaded. Isn't it true that Conrail has taken full advantage of that agreement and consistently reloaded the maximum number of boxcars? What is wrong with that as a solution to Conrail's empty boxcar problem—at least you are saving a substantial amount of car hire compensation?

Answer. The existing regulatory structure and car hire formulas continue to encourage the loading of one's own car and the wasteful returning home empty of foreign cars. The result is the accumulation of millions of wasteful, empty car miles, costing the railroad industry over $300 million annually.

BRAE's short lines, however, for the most part do not *want* their cars returned home empty. BRAE has solicited other railroads to reload BRAE cars at a reduced car hire rates because the short line roads to which these cars are under lease could not, and still cannot, produce the loadings to support the volume of cars to which they were committed. The reduced car rent was designed to encourage Conrail to reload BRAE cars anywhere so that BRAE could continue to earn car rental fees. These BRAE cars are good quality and Conrail has attempted to gain the greatest possible benefit from BRAE's initiatives. Although the BRAE agreements have perpetuated some wasteful empty mileage and do involve higher-than-market car hire rates, Conrail believes that workable agreements can evolve from them to continue the use of BRAE cars under deregulation. Our preliminary meetings with BRAE on the subject ended, however, when BRAE indicated that its counsel has advised it to terminate further discussions with Conrail.

BRAE owns only 1 percent of the National fleet. The incentive for most carriers, large and small, is still to request their own car back regardless of the empty miles incurred. These excessive empty miles must also be eliminated.

Question 6. Do you have such reload agreements with other boxcar owners? How many boxcars are covered?

Answer. Conrail has several such reclaim arrangements, involving approximately 20,000 plain boxcars which are owned or controlled by non-railroads. There are also numerous reload agreements involving railroad-owned cars.

Question 7. Conrail has made it clear that it sought the new rules in order to obtain a substantial decrease in the amount of car hire compensation it pays. Thus, by definition, won't the owners of the boxcars Conrail needs receive less than adequate compensation for the use of their boxcars? If the current formula is two years out of date to start with, and if the owner has to now pay storage reclaim and empty return charges, how can the owner receive fair compensation?

Answer. Conrail sought deregulation to reduce total boxcar costs (car hire and empty miles) to make boxcars more competitive. Unlike other Class I carriers with large coal traffic bases, general merchandise boxcar traffic is an important segment of Conrail's freight volume, generating approximately $800 million in revenue, almost 30 percent of Conrail's total for 1982.

Since 1970, the national loading of 50′ plain boxcars have fallen by 47 percent, from 1.7 million cars in 1970 to .9 million cars in 1982. At the same time, the national 50′ plain fleet has grown by 54 percent from 114,000 cars in 1970 to 175,000 cars in 1982. The estimated 50′ plain boxcar surplus exceeds 70,000 cars. With this surplus, overall compensation has already fallen dramatically. By reducing costs, deregulation offers the opportunity to increase demand for boxcars. It is difficult to understand a regulatory formula that raises car hire for cars that are being made obsolete by high regulated costs and prices. "Adequate compensation" is something that must occur over the life of a car if it is to be replaced. The competing truckers do not try to earn the replacement cost of their rigs in slack times. If railroads try to do so (as they have been), they will lose the business to lower-priced truckers (as they have been).

Boxcar ownership compensation should be determined by the market, with boxcar owners receiving greater compensation in times of high demand and lower compensation in times of car surplus. Clearly the current prescribed car hire formulas and restrictive car service rules have increasingly made the overall costs too high to complete. The result is idle boxcars.

Short line carriers do have leverage in the traffic they originate and the customers they serve. Conrail's objectives are not to store large numbers of cars or charge 35¢ for empty car miles. Storage of cars is expensive for Conrail and only makes economic sense when there are prospective loadings nearby. It costs us 47¢ a mile to move an empty car, so we would rather avoid the empty move than charge 35¢. In the bilateral agreements, Conrail seeks to change empty flows and to minimize use of the 35¢/empty mile charge. Some cars will continue to be returned empty, free of charge, to meet customer requirements. But we must have these new tools to encourage changes.

The transition to this new environment must be gradual and Conrail has already informed all boxcar owners that we will not store cars or assess the 35¢ charge until

Conrail and the car owner have had the opportunity to negotiate the possibility of a mutually acceptable bilateral agreement.

Question 8. Has Conrail begun negotiating alternative car hire contracts under the new rules? Has Conrail negotiated with any Class III railroad?

Answer. Conrail has been discussing bilateral agreements for several months with all major boxcar owners. Two agreements have already been signed, including one with a group of five Class III carriers. Several more agreements are at the handshake stage and probably will be reached in September. The agreement with the Class III carrier provides savings for in the reloading of inbound cars and also provides some freight price reductions to customers. These agreements focus principally on empty flows, not car hire, and both agreements avoid assessment of the 35¢ charge under most circumstances.

These bilateral negotiations would be proceeding much more swiftly if all parties were completely convinced that boxcar deregulation will not be postponed or modified to protect third party investments.

Question 9. What bargaining position does a short line railroad have in negotiations with Conrail? How much traffic does any given Class III railroad produce for Conrail's lines? How many empty Conrail boxcars does any given Class III railraod have on its lines at any time?

Answer. The bargaining position of the Class III carrier is in the traffic it originates and the ownership of high quality cars. Conrail has a small boxcar fleet and wishes to keep as many Class III lines as possible in the business of supplying cars so that we shall not be left to the vagaries of the supply of a handful of Class I lines. Moreover, many Class III carriers are owned by large customers who control substantial traffic (often traffic over and above that originated by the Class III carrier). Short lines generate significant volume of traffic and it is in Conrail's interests to have them survive.

In 1982, Conrail received 30,432 loads in plain and equipped boxcars which originated on Class III roads, including terminal switch lines. This represents about 8% of all received boxcar traffic handled. These 30,432 loads generated to CR revenue of approximately $30 million. These originations range from as few as one car per year to as high as 2,167 cars. Of 120 roads represented: 8 produced over 1,000 cars each, or 37 percent of total; 13 produced over 500 cars each, or 26 percent of total; 37 produced over 100 cars each, or 31 percent of total; 62 produced up to 100 cars each, or 06 percent of total.

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An examination of a recent one-week sample of Conrail's traffic found that out of 1,470 plain 50'ft. Conrail-owned boxcars loaded on Conrail, only 43 terminated on Class III railraods. An important reason is the fact that Class III railroads which have boxcars bearing their reporting marks have almost always loaded such cars in perference to other railraods' cars.

Question 10. What kind of concessions has Conrail made in these negotiations? What kinds of concessions are you willing to make? Isn't it true that Conrail really doesn't have to make any concessions.

Answer. In general, Conrail is seeking the following provisions in the bilateral agreements: Incentives for each party to reload the other party's equipment; freedom for Conrail to send certain empty cars to closer connections than the connection to the car owner; freedom to store a certain percentage of cars for prospective loads; Conrail agrees to return empties back to the owner for certain categories of cars with little or no empty mileage charge assessed; and modest reductions and/or a ceiling on car hire.

If Conrail were trying to destroy the boxcar business no concessions would be needed. Conrail must make concessions as it is attempting to improve the boxcar business and for that to happen, all participants must earn a reasonable return. Conrail has already committed to start making boxcars more competitive by offering a $50 refund to customers for all shipments moving to the West in western-mark boxcars. This reduction will begin on the effective date of boxcar deregulation.

Question 11. If owners of boxcars and short line railroads can't survive under the Commission's Order, what will happen to their boxcars?

Answer. If any railroad can't survive, its freight cars are sold to the highest bidder. But it is not the Commission's order which will determine survival. Boxcars without loads will own no car hire. And there will be no loads for boxcars, possibly by the end of the decade, unless costs and prices can be reduced in a way that only deregulation can make possible.

Question 12. Many in industry contend that the new car hire rules are ambiguous and require additional clarification. Does Conrail concur?

Answer. Conrail believes the ICC order is clear and unambiguous. The administrative details of deregulated transactions can be resolved by the carriers in the bilateral agreement process just as the parties to any other commercial transaction work out the administrative details.

Question 13. Is Conrail in favor of staying implementation of whole or part of the Commission's Order until these issues are resolved?

Answer. No. A stay or postponement will merely further delay the process of increasing the competitive position of boxcars and perpetuate existing inefficiencies and excessive costs. Conrail is opposed to any delay. Conrail recognizes that the transition to a deregulated environment must be gradual and it is publicly committed to maintaining existing agreements until opportunities to negotiate substitutes have been explored. The longer the process is delayed, however, the less boxcar traffic there will be to deregulate.

Senator DANFORTH. Thank you.

Senator Exon.

Senator EXON. Thank you, Mr. Chairman.

Mr. Snow, did I understand you to say that coal rates were actually going down on the CSX system? Is that right?

Mr. SNOW. Yes, sir, in real dollar terms.

Senator EXON. Are there any captive shippers in your system?

Mr. SNOW. Well, Senator, that depends on whose definition of "captive," I suppose. There are certainly shippers who would claim to be captive, I would put it that way. There are shippers who would claim to be captive.

Senator EXON. And since your rates have gone down in real terms, I assume you have had no complaints in the CSX system?

Mr. SNOW. Senator, I think the fact that our rates have gone down is suggestive of the limited degree of market power which we actually enjoy, at least relative to the statements of some of our critics in the coal industry and the utility industry. If that is monopoly power, it is the most ineffectual use of monopoly power one could envision.

Monopolists do not lower their rates. Monopolists raise their rates when they have revenue shortfalls. We are not in a position to be able to raise our rates because of the sort of thing that Mr. Marshall just talked about. His company is putting in a rate reduction that I was not aware of until this morning, that is going to affect our movements out of West Virginia. I cannot say I am happy about that, but that is the name of the market game. That is the way that game is played today.

And you know, we cannot on the one hand say we want to be for free enterprise for everybody else but not for ourselves, and that is the position I think some of our critics are in.

Senator EXON. May I turn to you, Mr. Boyce, with a question or two. The Burlington Northern financial picture has been especially bright, I believe. Has your stock not almost tripled in the last 5 years or so? Things are going well for Burlington Northern, are they not?

Mr. BOYCE. Only in comparison to where they were a few years ago. And I mean that seriously. The rate of return on the total assets of Burlington Northern last year was about 3 percent. If you look back in the mid-seventies, there were some years that it got down to 1½. So you could say that our return has doubled, from 1½ to 3. That is only good in comparison to where it was.

Senator EXON. Has your stock not tripled in the last 5 years?

Mr. BOYCE. The stock has tripled. That is an investor judgment. That does not provide profits to the company.

Senator EXON. No; but that shows that at least people who are interested in investing think you have a pretty sound future ahead of you, is that not right?

Mr. BOYCE. So do we. We think we have a sound future ahead of us.

Senator EXON. Well, I congratulate you on that. I think we are all in favor of that.

Mr. Boyce, have you reduced your rates for hauling coal like CSX?

Mr. BOYCE. Senator, I was not asked to prepare testimony in the coal rate area, so you will forgive me if my answers are general. I would be happy to give more specific information to any of the questions.

Senator EXON. You can supply it for the record. So you would rather not comment on the record at this time, until you check as to whether or not you have raised rates in the Burlington Northern system?

Mr. BOYCE. I know that some have gone up and some have gone down. I would be happy to supply for the record more precise information.

Senator EXON. I would appreciate that.

[The following information was subsequently received for the record:]

At the time of the Staggers Act our coal rates were generally at a depressed level, certainly no where close to covering the billion dollar investment we had made for this traffic. The Staggers Act gave us the opportunity to bring our coal rates up to reasonable levels that would allow for financial viability. We have been partly successful in this regard, using negotiation wherever possible and litigation wherever necessary but still have a way to go.

In many cases, the transportation contracts we have entered into with major customers have provided for lower rate levels or rate levels lower than would have been the case had the contract settlement not been reached. Reduced transportation costs are obviously a major incentive for coal shippers to enter into Section 208 contracts. At present we have about 25 percent of our coal volume covered by such contracts, including Nebraska Public Power District, Hastings Utilities and Grand Island Utilities in Nebraska. We have also entered into contracts with Northern States Power, Commonwealth-Edison Public Service Company of Colorado, American Electric Power and Oklahoma Gas and Electric.

In the past year or so, we have made rate reductions on coal moving to a utility in Iowa from Kansas and Oklahoma and from southern Illinois to a utility plant in Alabama. We have instituted several rate reductions on Illinois coal into southern states and on coal originated on the Denver and Rio Grande moving to Ft. Collins Colorado.

Senator EXON. Generally speaking, the railroads have more or less been fond of saying that coal simply does not pay its fair share. Yet I would submit that evidence submitted to the ICC in Docket 3902 with regard to Burlington Northern showed that, while Burlington Northern's coal rates average 197 percent of costs for providing the service, the comparable ratio on noncoal traffic is 117.

Further, the evidence shows that 45 percent of Burlington Northern's alleged revenue shortfall is attributable to noncoal traffic moving below cost, while only one-half of 1 percent of Burlington Northern's coal traffic moves at such a noncompensatory level.

In light of the evidence of this type, which I understand is regularly submitted in cases like this, how can the railroads persist in their claim that coal must pay a greater share of revenue needs, at least in the case of Burlington Northern? Evidently that is not the case with CSX, based on the testimony submitted by Mr. Snow.

Does not Burlington Northern still maintain that coal overall is not paying its fair share?

Mr. BOYCE. I think we have to look at each movement individually, Senator, and determine whether or not that movement is earning a rate of return that allows continued investment and would allow that service to continue on a long-term period.

Senator EXON. Thank you, Mr. Boyce.

Would any member of the panel care to comment on something that I have mentioned two or three times this morning, and with regard to other panels: What do you suspect would likely happen to the coal hauling of the railroads if we have widespread introduction of coal slurry pipelines into the coal-hauling area? And what do you anticipate that that generally might do at least to that portion of your revenue that would come from hauling coal some time in the future?

You must have looked at that.

Mr. DEMPSEY. Yes, we certainly have. I will not ask you to take what we say about it as the basis for your judgment. Rather, let me simply cite to you the findings of the Office of Technology Assessment, that studied this problem a few years ago, I think it is the best study that has been made.

There were then five coal slurry pipelines on the drawing boards, and according to the OTA, in terms of 1973 dollars if those five pipelines were built, by the year 2000 the rail industry would lose about $700 million a year in net revenue. Now, in those terms, that is more money in net revenue than the industry has made in any of the last 10 years.

We now have 13 coal slurry pipelines on the drawing boards. So if I may be permitted to make an extrapolation, I guess what we are looking at is something in the way of a billion and a half dollars in net revenue loss to the industry. The industry simply could not stand it.

Senator EXON. I only mention that because I really believe that when we are talking about all these issues, which are extremely complicated and hard to get a handle on, we have to look at the long-term picture, because certainly you people in the railroad industry know that those of us who have constituents to serve out there—and serve them we will—are very much concerned about what is going on in this area today, and what we do here has a reflection on what happens over there.

Thank you for your testimony. My time is up.

Mr. DEMPSEY. One point of clarification. I want to make certain that there is no misunderstanding. Mr. Snow is talking in terms of the decline in coal rates in real dollar terms. His rates I am sure have gone up to some extent. And speaking not for CSX but for the industry as a whole, of course we have gotten complaints, because the coal miners, the coal mines and utilities would rather have rates not go up at all, or go down if possible.

Senator EXON. Thank you.

Thank you, Mr. Chairman.

Senator DANFORTH. Senator Long.

Senator **Long**. Mr. Chairman, I would like to submit some questions to the ICC.

Now I want to ask Mr. Dempsey, if major segments of a railroad have little or no captive traffic while other segments have significant captive traffic, should the captive traffic be called upon to subsidize the segments that it does not use?

Mr. **Dempsey**. Well, I think that this is one of the issues, of course, in the coal rate proceeding. And I am not an expert in this at all.

Senator **Long**. I am just asking you to state the position of the industry.

Mr. **Dempsey**. I am not sure that I can state it. I had better answer that in writing.

Senator **Long**. Well, state your position then.

Mr. **Dempsey**. As I understand it, the Commission would not take that position, but I will submit in writing the position of the industry on that point, Senator. I am not really prepared right now. As I say, I do not think the Commission is going that route.

[The following information was subsequently received for the record:]

While there has, to my knowledge, never been any official industry position on this issue, all of the major railroads have testified in the Commission's coal rate guideline proceeding, Ex Parte No. 347 (Sub-No. 1), that, as a general rule, shippers should not be required to pay more than the full economic costs of providing the service they require. In other words, shippers should not be called upon to cross-subsidize other shipper's costs unless those costs are forced upon the railroad by regulation.

Thus, for example, if shipper A does not use line B and does not want the revenues from traffic moving to, from or over line B to contribute to the costs of shipper A's service, then shipper A should not be required to help pay the costs of line B. The stand-alone cost test, which prevents shipper A from having to pay more than the costs of its service, prevents any such cross subsidy. At the same time, nothing should prevent the railroad in this example from seeking to cover the cost of line B and all other assets from the shippers who benefit from them. Thus, the Commission's overall revenue adequacy standard is (and should be) based on the cost of all a railroad's assets. This is perfectly reasonable so long as no shipper is required to pay more than the costs of the benefits it gets from the railroad.

Now, I should note that it is most often the case that the assets used by some shippers are used by others. Thus, when we apply the stand-alone cost test to prevent cross-subsidy of one shipper or group of shippers by another, if we include any revenues from traffic which uses their lines, we must also include all the costs of generating those revenues. When all the revenues and costs are properly compared, the shippers are usually in about the same position as they would be if we based their rates on their economic share of the cost of the whole railroad. The reason for this is that the benefits most shippers get because the railroad is serving other shippers, far outweigh their share of the cost of serving those other shippers. Of course, many captive shippers are also benefitting because, together or alone, they are not paying what it actually costs to provide their service. From our perspective, the real problem here is that because of inadequate revenues, these shippers are being subsidized not by other shippers but by the railroads and their shareholders.

Senator **Long**. Now, should more prosperous coal hauling railroads be allowed to merge with less prosperous railroads that have little captive traffic?

Mr. **Dempsey**. If they wish to merge and submit an application to the Commission, I do not see any reason why they should not be permitted to do it, provided that it does not have unduly anticompetitive effects.

Senator **Long**. You see what that means, though. That sets the stage for a big increase in the cost of hauling that coal.

Mr. **Dempsey**. Depending on the answer to your first question.

Senator **Long**. That is fair.

Now, let me ask Mr. Snow, has your railroad ever presented evidence of the stand-alone cost of captive coal hauling?

Mr. **Snow**. Senator, not that I am aware of. I do not think that we presented evidence on what the stand-alone cost would be in the Ex Parte 347 proceeding, and I am not aware that we have ever definitively determined what those stand-alone costs would be, frankly.

Senator **Long**. Thank you.

Senator **Danforth**. Mr. Boyce, earlier Chairman Taylor testified concerning the contract entered into between the Arkansas Power & Light Co. and the Chicago Northwestern Transportation Co. and Union Pacific system. He stated that the story of that contract was the story of competition between the railroads and even the possibility of a coal slurry pipeline.

It looks to me in reading the newspaper story of it is that it was not a question of competition between a railroad and the possibility of a coal slurry pipeline, but rather it was a story of the competition between two railroads, one of which was Burlington Northern.

Is that a correct interpretation of the situation?

Mr. **Boyce**. Mr. Chairman, my understanding is that Arkansas Power and Light received three bids for their coal transportation—one from the proposed ETSI coal slurry pipeline, one from the Northwestern, and one from Burlington Northern. So I would say there was three-way competition.

Senator **Danforth**. But there is certainly interrailroad competition.

Mr. **Boyce**. All three bids were competitive factors, that is correct.

Senator **Danforth**. Now, with respect to the ICC and the terms "return on investment" and "return on current cost of capital." Return on current cost of capital is a meaningful economic consideration as far as the ICC is concerned. Does that have any history, to the best of your knowledge?

Mr. **Boyce**. The term "return on cost of capital" is a confusing one to me.

Senator **Danforth**. Current cost of capital.

Mr. **Boyce**. I do not know how you get a return on—you get a return on assets or you get a return on investment. The term "return on current cost of capital" is not one that——

Senator **Danforth**. You understand what they mean by it?

Mr. **Boyce**. I know what current cost of capital is, yes.

Senator **Danforth**. But as far as you know, it does not have any history?

Mr. **Boyce**. I can compare a return on the investment which a company has in its facilities with its current cost of capital. That may be what you are referring to.

Mr. **Snow**. Senator, could I take a shot at that?

I think any first-year finance book will set forth a concept of the current cost of capital, and it will say that a firm that does not earn the current cost of capital on its investments and its assets is not going to stay in business; that the sine qua non of staying in business is earning the current cost of capital on your investments.

So it is a well-tried and well-known concept which, to my knowledge, has been applied with great regularity in the utility industry. It is a concept which has wide application in the utility industry itself.

Senator DANFORTH. Mr. Dempsey.

Mr. DEMPSEY. I would simply echo that. Surely the bulk of economic opinion would be exactly as Mr. Snow says; you must earn the current cost of capital in the long run.

Now, as one of the previous witnesses said, in the short run you can use funds flow analyses and a variety of other criteria, and you can get by. But the Commission quite appropriately, it seems to us, has taken the long-run test to apply in the Staggers Act.

There are all kinds of technical arguments about how you calculate the current cost of capital, on the one hand, and how you determine your net investment on the other. Many of those are before the Commission right now in the ongoing adequate revenue proceeding.

Senator DANFORTH. Mr. Marshall.

Mr. MARSHALL. I agree with Mr. Dempsey.

Senator DANFORTH. Gentlemen, thank you very much.

We now have the utility panel of Mr. Doyle and Mr. Whelan.

Mr. Doyle.

STATEMENTS OF ARTHUR J. DOYLE, CHIEF EXECUTIVE OFFICER, KANSAS CITY POWER & LIGHT CO., ON BEHALF OF THE EDISON ELECTRIC INSTITUTE, ACCOMPANIED BY PAUL ZIEMER, CHIEF EXECUTIVE OFFICER, WISCONSIN PUBLIC SERVICE CORP.; AND OF GERALD WHELAN, ON BEHALF OF THE WESTERN COAL TRAFFIC LEAGUE, CONSUMER OWNED POWER COALITION, AMERICAN PUBLIC POWER ASSOCIATION, AND NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION, ACCOMPANIED BY C. MICHAEL LOFTUS

Mr. DOYLE. Mr. Chairman, on behalf of the electric utility industry I have two written statements that I have been requested to ask be introduced into the record. One is by the Rail Shippers Coalition, signed by 11 national organizations and groups. The other is prepared testimony of the Consumer Federation of America.

May those be introduced?

Senator DANFORTH. Fine. Thank you.

Mr. DOYLE. Thank you, Mr. Chairman.

Today Mr. Ziemer and I are representing the captive coal shippers of the electric utility industry. I will point out to the committee, right now, that the rail freight rates we pay, our costs, our customers' costs and for the most part are passed directly on to the consumer in the same month or at least within the same 12 months. To that extent, therefore, we are representing all of the electric ratepayers, the public of this Nation.

What I want to do is tick off for you six areas where we believe the ICC has ignored, misinterpreted, sidestepped or blatantly refused to follow the mandates of Staggers.

One, revenue adequacy. Prior to Staggers, the ICC found 13 of the 36 class I railroads in this country, under the multifaceted test of the 4R Act as adopted by Congress, to be revenue adequate.

After Staggers, the ICC adopted a new definition using a new single test called "current cost of capital on net investment." The result: not a single one of the class I railroads is now revenue adequate under the ICC's new definition.

I submit to you, gentlemen, if you will look at the 1982 Annual Report of the Burlington Northern Railroad, I think you will find that the return on its common equity supplied by its common stockholders was significantly greater than the 3 percent just mentioned.

What is wrong with the new test? Three failures as compared to generally accepted accounting practices which are applicable to our electric industry. One, the ICC's new test of revenue adequacy ignores the embedded costs of both debt and preferred capital. Second, it understates earnings by deducting "betterments" as an expense, or under the ICC's new replacement accounting that the railroads are going to be using, by deducting economic depreciation after valuing up all of the historic costs to replacement costs. Third, it overstates net investment. How? By adding deferred taxes to net investment.

I suggest to you that some computations that I have seen indicate that if you are talking about a "current cost of capital" for the railroads of say 16 percent on that "Net investment," you are really talking about figures in excess of 40 percent return on the common equity, or on the investment by the common stockholder.

Let us talk about the revenue-to-variable-cost ratio as fixed by the Congress. The ICC proposes now to shift some of the railroads' total costs, which prior to Staggers were classified as fixed costs, and now assign them as variable costs to raise its congressionally imposed threshold jursidictional authority and thus allow higher captive coal rates without the possibility of ICC review.

Let's look at twin balancing now as the third item. This Congress in Staggers clearly laid down a twin mandate: one, assist the railroads to achieve revenue adequacy, as was then defined; but second, to do it at rail rates which do not exceed a reasonable maximum where no competition exists.

Congress said to the ICC: Balance and accommodate these two objectives. Has it been done? No. The ICC has exclusively focused on the revenue adequacy mandate and has ignored the reasonable maximum rate mandate. Effectively the ICC has declared that no captive coal rate at any level—215 percent or more in one of my cases—to be unreasonable so long as the railroad—Burlington Northern in this case—is revenue inadequate per its new definition.

Fourth, market dominance. Even though Staggers retained the ICC pre-Staggers view of the market dominance, the ICC then reversed its position and now includes consideration of product and geographic competition. Result: Rail rates for fewer captive coal shippers are now subject to regulation.

Fifth, the Long-Cannon amendments. Frankly, and briefly, the ICC has ignored them and frustrated every attempt of shippers to get the data and information, known only to the railroads, in order to implement these provisions.

As already discussed, Arkansas Power & Light tried to get that data and information and have the Commission start a rulemaking. What happened? The ICC refused to start a rulemaking and refused to order the railroads to produce the data and information. Instead, the ICC said go and do it on a case-by-case basis but the ICC then reduced the number of cases in which we could get the Commission to take jurisdiction.

Finally, the Ex parte 347 guidelines. Simply stated, they are exactly what the New York Times criticized them to be in an editorial. The headline said "Constraints Without Restraint," and that is exactly what they are.

Stand-alone. In a Potomac Electric case, the Chessie Railroad claimed a $13 per ton rate could go to the stand-alone cost of $182 a ton and not be unreasonable. Conrail, same thing. A $10 per ton rate could go to [illegible]59.

Gentlemen, mathematically we all know that 15 percent doubles in 5 years, quadruples in 10 years. In our industry, the public's cost of rail transportation for coal is estimated this year at $5 billion. Under that particular element of the guidelines' matrix, the rates which the ICC has encouraged the railroads to go to would aggregate $10 billion by 1988, $15 billion by 1991, and $20 billion by 1993.

Gentlemen, we ask you, urge you to exercise your oversight authority and send a clear mandate to the ICC directing it to follow the intent of this Congress when you laid down all of the provisions of the Staggers Act. Also, if by the ICC's own mischief since Staggers, it now requires legislative amendments to do so, we ask that you enact those amendments to make it crystal clear that this Congress means what it said in Staggers

Thank you.

Mr. Ziemer and I are not experts. We have others with us and we will try to answer all your questions.

[The statements follow:]

STATEMENT OF ARTHUR J. DOYLE, ON BEHALF OF KANSAS CITY POWER & LIGHT CO. AND EDISON ELECTRIC INSTITUTE

Mr. Chairman and members of the Subcommittee: I am Arthur J. Doyle and I am Chairman of the Board and President of Kansas City Power & Light Company. With me is Paul D. Ziemer, President and Chief Executive Officer of Wisconsin Public Service Corporation. We appear on behalf of the investor-owned utilities which comprise the Edison Electric Institute and which provide 77 percent of all electric power purchased in the United States.

We are here, on behalf of the electric utility industry and its customers, to call your attention to the immediate need for Congress to reject the Interstate Commerce Commission's ("ICC") grossly erroneous interpretation of the Staggers Rail Act of 1980.

In that statute, Congress concluded that certain shippers—particularly coal shippers—we have no realistic alternative to using the railroads and therefore, unless rates are regulated by the Interstate Commerce Commission, must pay whatever the railroads choose to charge. To protect consumers of electricity—everyone—from being victimized by sky-is-the-limit railroads rate increases, Congress decided that regulation by the Interstate Commerce Commission of rail rates for this captive traffic was essential. Indeed, certain additional rate reasonableness factors to be considered by the ICC were set forth in the Long-Cannon Amendment but have been virtually disregarded and systematically buried.

Instead of carrying out their statutory responsibilities, the members of the ICC, in a series of actions, have established a system of non-regulation that authorizes the railroads to exercise unrestrained monopoly power over coal rates. Unless Congress intervenes, the stage has been set for utility coal transportation rates (all borne by the consumer)—currently about $5 billion annually—to double in five years, triple in eight years and quadruple in ten! These hearings are a vital first step in Congressional reassertion of control over a runaway administrative agency.

We wish to emphasize in this regard that the electric utilities are not here seeking to turn back the clock by imposing new regulations upon the railroads. The present law, properly interpreted with recognition of the true costs of service, provides the nucleus for protection against excessive coal rates, even if a carrier is revenue inadequate as a result of other traffic. The ICC, however, has completely disregarded and frustrated the legislative intent. The purpose of the Congress should be made so clear as to preclude misinterpretation by the ICC.

SUMMARY OF ICC DISTORTIONS OF THE ACT

I. The ICC has ignored one of the twin goals in the balanced approach to regulation mandated by the Congress, the protection of captive shippers against excessive rates, in its single-minded focus upon assisting the railroads in achieving revenue adequacy.

II. The ICC has undertaken to define the phrase "revenue adequacy" as used in the Interstate Commerce Act in a way that no major railroad ever achieves that level of financial success and hence that no captive shipper will ever be protected. With certain provisions of the Staggers Act keyed to the determination of revenue adequacy the ICC jettisoned the revenue adequacy standards in place when the Staggers Act was passed. Instead, the ICC decided to rely upon a return on investment equation which overstates investment and understates earnings. As a result thirteen Class I railroads (about one-third of the Class I's) that had earlier been found by the ICC to be earning adequate revenues wre subsequently reclassified by the ICC as "revenue inadequate."

III. The ICC has reversed its position on market dominance, notwithstanding the fact that the Staggers Act retained the prior definition of market dominance, to include complex antitrust-type consideration of product and geographic competition, thereby reducing the number of coal rates subject to its jurisdiction.

IV. In developing an inflation index the ICC has confused costs with prices and is relying upon the latter to deprive shippers of the benefits of productivity, which is in many instances attributable to shippers themselves supplying cars or shipping in greater volumes.

V. The ICC has done little more than accord "lip service" to the Long-Cannon Amendment, frustrating all shipper efforts to implement the requirements of that Amendment aimed at allowing a subsidy from captive coal traffic only to efficient railroads.

VI. The ICC is now undertaking to apply in reopened coal rate cases rate guidelines that are the equivalent of maximum exploitation of railroad monopoly power over coal traffic. Under this most recent proposal, the ICC has abandoned earlier reliance upon cost-based ratemaking to espouse a standard that one railroad claims would permit it to increase its rates from $13 per ton to $182 per ton.

WHY COAL RATES ARE OF SUCH EXTRAORDINARY CONCERN

For many reasons well known to Congress, the efficient use of U.S. coal resources is vital to our economy and national security. The primary use of coal today is for the generation of electricity. During 1982, the production of 53 percent of our nation's electricity required 601 million tons of coal—85 percent of domestic coal consumption. Electric utility demand for coal continues to grow. By 1990, utilities estimate they will require 823 million tons of coal annually to generate the nation's electricity.

About 60 percent of the coal being used by electric utilities today is delivered by railroad. The cost of delivering coal by rail, on a national average, currently accounts for substantial portion of the delivered coal price paid by utilities. In some cases, the cost of rail transportation is almost 80 percent of the delivered price. Approximately 75 percent of the coal tonnage hauled by our nation's railroads during 1982 originated on three railroad systems:

Railroad	Millions of tons originated	Percent Nation's total
CSX Corp	165.3	31.3
Norfolk Southern	116.0	22.0
Burlington Northern	112.1	21.2
Total	393.4	74.5

Moreover, through on-going mergers sanctioned by the ICC, the railroad industry is becoming extremely concentrated in the hands of a few "super-railroads". Hence, the forces of competition envisioned by the Congress as minimizing the need for regulation are fast eroding, making it all the more essential to maintain effective regulation of captive traffic. As an article in the June 19, 1983 Washington Post stated:

"Over the next decade, a combination of mergers driven by intense competition between trucks and railroads will result in a few—probably three—super railroads.

"Railroad experts in government, the industry and the financial world are in unusual agreements on the scenario, although most of them would discuss the matter only if they were not identified.

"There is also substantial uneasiness—particularly among coal and grain shippers and their states as to whether deregulation of transportation will go too far and leave some sections of the country and those 'captive' rail shippers at the mercy of a predatory monopoly."

No one can doubt that electric utilities must use the railroads to deliver coal. The majority of power plants currently using rail transportation of coal have no alternative means of coal transportation available and are thus "captive" to the railroads. In many cases a single railroad exercises complete monopoly power, as is the case when a generating station is served by a single railroad or a mine on which a utility is dependent for coal is served by a single railroad. All of this means that the railroads serving captive traffic may raise their rates without fear of competition or any risk of decline in the volume of traffic.

Costs of fuel to generate electricity, including costs of transportation of steam coal, must be borne by the consumers of electricity. The $5 billion spent by utilities last year for rail transportation of coal—large as this sum is—tends to obscure the impact of coal transportation costs for particular applications and on individual communities. The impact of rail coal rates is already very substantial and increases in these rates, or approval of existing rates, unrelated to costs are particularly threatening. It is indisputable that economically justifiable rates for hauling coal are essential to national energy policy.

COAL ALREADY IS CONTRIBUTING FAR MORE THAN ITS SHARE TO RAILROAD PROFITS

Electric utilities are a regulated industry and strongly endorse the right of other industries, including railroads, to recover their legitimate costs and a reasonable return on their investment in their regulated activities. Further, electric utilities fully support the railroads' right to recover fully and promptly their increases in costs due to inflation. The crucial issue is whether the railroads, by taking advantage of their monopoly power over coal traffic, are extracting unreasonable profits. We are here to tell you that the ICC, purporting to implement the Staggers Rail Act, has created a regulatory environment in which the railroads are not only permitted but encouraged to extract unreasonable profits from captive traffic.

Coal is the principal commodity carried by the railroads. It contributes the greatest tonnage, the greatest revenue and the greatest profit to the railroads. As Stephen R. Klein, Railroad Anayst, reported in Standard & Poor's July, 1982 Railroad Report:

"The railroad industry is experiencing a renaissance fueled by rising coal traffic. The railroad's steady erosion in profitability and diminishing share of freight transportation has been arrested by the expanding role played by coal in meeting world energy needs. Today, the fortunates of a number of railroads are inextricably bound to coal: Coal traffic generates more than one-third of originated revenues—percentages well above those of other commodities hauled. *Coal's contribution to profits is even higher than to revenues since subsantial amounts of coal are transported via highly labor-efficient unit trains.*" (emphasis added)

The railroad fully acknowledged the role coal plays. As Frank N. Wilner, Director of Issue Development for the Association of American Railroads said earlier this year:

"Coal represents our past, our present and our future. It is the one commodity that has kept us afloat during this prolonged recession, and it is the one commodity that will help vault us into the 21st century."

Table No. 1 and Figure No. 1 compare the railroad revenue and hauling cost per ton of coal to that of all other traffic. It can be seen that coal yields an operating profit of 32.6 percent while other traffic yields only 18.6 percent. In other words, the railroad's operating profit on coal already is 75 percent greater on a per ton basis than the operating profit of all other traffic.

Taking the analysis one step further and comparing coal on a ton-mile basis yields the same results. From Table No. 2 and Figure No. 2, it can be seen that on a ton-mile basis, coal yields an operating profit of 32.7 percent while all other traffic yields only 18.5 percent. The railroad's operating profit on coal on a ton-mile basis is 77 percent greater than that of all other traffic.

A similar showing can be made for railroad components of major coal carrying railroad systems. Testimony to be filed July 28, 1983 in Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines—Nationwide* by Mr. John M. Anderson of A. T. Kearney, Inc. shows, for example, that for the Burlington Northern coal traffic earns 179 percent of variable cost but its other traffic only 117 percent. Similarly, Chessie, coal rates, including single car traffic, reflect 145.4 percent of variable cost but its other traffic produces only 124.5 percent of such cost.

Carriage of utility steam coal is risk-free for the railroads since this traffic must move in regular assured volume. A major reason why coal is so profitable for the railroads is that it is increasingly being carried in unit-trains, the most efficient form of rail transportation, and because utilities are supplying more and more of the equipment and facilities used to haul their coal. The overall effect is to reduce sharply the railroads' cost of service.

COAL RAIL RATES HAVE INCREASED IN CONSTANT DOLLARS AND THE STAGE IS SET FOR FURTHER DRASTIC INCREASES

In a competitive industry one would expect that price increases would approximately cost increases over the long run. But the railroad industry—insofar as it serves electric utilities—is *not* a competitive industry. This means that the railroads serving captive utility plants can and do raise their rates without fear that a competitor will take the business.

In the years since 1976 coal haulage rates per ton-mile have increased 10 percent above the level of inflation. See Table No. 3. This is in spite of the fact that length of haul has increased (so rate per ton-mile should decrease); very efficient unit trains are used with greater frequency; and shippers have supplied increasing amounts of equipment and facilities themselves.

What has happened to date is serious, but it is like a "cloud no bigger than a man's hand" compared to what is in store for the nation's consumers! What the ICC has done through Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines—Nationwide* decision is to set the stage for a tremendous, unjustified transfer of wealth from the consumers of this country to the Railroads via the mechanism of electric utility rates.

THE ICC AND RAILROAD REVENUE ADEQUACY: A CLASSIC CASE OF TUNNEL VISION

Congress was influenced in recent legislation to sweep away regulatory controls, where the railroads lacked market dominance, to allow "rail carriers to earn adequate revenues." (See, particularly, subpara. (3) of the new "Rail Transportation Policy," set forth in Section 101(a) of Staggers Act.) Thus, railroads were given flexibility to set rates on competitive traffic.

But, the message Congress delivered to the Commission also contained a directive regarding the extent to which railroads could be allowed or encouraged to improve their revenues through increased demands of subsidies from captive shippers that have no option but to pay them. The Conference Report supporting passage of the Staggers Act had this to say, with particular reference to captive coal shippers:

"The Conferees intend that this policy include the encouragement and promotion of the transportation of coal by rail in accordance with the objective of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition." (H.R. Report No. 96-1430, dated 9/29/80, Title I, at p. 80.)

The same Rail Transportation Policy which favored adequate revenues also declared it to be the "policy of the United States government" "to maintain reasonable rates *where there is an absence of effective competition . . .*" (para. (6) of Section 101(a) of the Staggers Act).

As stated in the Conference Report on the Staggers Act, at page 94:

"The Conferees intend that the Commission give due regard to two things, whether a rate increase would mean excessive profits, and the need for a rate increase in light of the carrier's revenue position taking into account the policy of this Act that inadequate revenue carriers make adequate revenues. *This language is not intended to imply that excessive profits for inadequate revenue carriers are reasonable.*" (emphasis added).

The electric utility industry has a vital stake in the achievement of both of these partially conflicting policy objectives. As the nation's largest user of rail coal transport, we are alert and sensitive to the need for a vital and vigorous rail industry capable of meeting our expanding requirements for delivering our most abundant energy source. We recognize the need for adequate revenues on coal traffic, but, at the same time, we understand and heartily endorse Congress' explicity direction to the ICC that it be sure to "maintain reasonable rates where there is an absence of effective competition."

Congress delivered these two messages with the obvious expectation that the ICC could, and would, accommodate both by balancing the needs of the railroad industry for adequate earnings with the rights of captive shippers to protection from excessive charges. It is now clear, however, that the ICC has only heard, or, at least only heeded, the first message. The ICC has exalted above *all* other factors the railroads' need for "adequate revenues". It has done so, moreover, in the face of mounting evidence that the prospect of a huge capital shortfall in the railroad industry by 1985, projected several years ago, has melted away.

The ICC has tried its utmost not to find out the true condition of the railroads and exercise any balancing function. In a series of rulings, it has said that any shipper desiring rate relief must first prove (with data which can only be obtained from a railroad) that the railroad is inefficent. Then the shipper must further prove that the inefficiency, if corrected, would make the railroad revenue adequate. If this impossible burden were not sufficient, the ICC has followed up both by denying discovery outright and by requiring the shipper to prove his case in order to obtain the data with which to prove his case. See Docket No. 38946, order served June 23, 1983. *Petition of Louisville and Nashville Railroad Company for Review of a Decision of the Public Service Commission of Indiana Pursuant to 49 U.S.C. 11501;* Docket No. 38025S, *The Dayton Power and Light Company* v. *Louisville and Nashville Railroad Company,* order served April 29, 1983.

Sometimes it is difficult to believe that the members of the ICC and the rest of us occupy the same world. Since 1981, the ICC has repeatedly decided that *all* the major railroads are seriously "revenue inadequate". The ICC has made this nonsensical finding the bedrock of its other actions to free the railroads from any regulatory restraint, as we will explain in more detail below.

Moreover, the ICC has reached its conclusion despite the fact that, using accepted measures of financial condition, the railroad industry is doing better than the rest of the nation's industries. Even the AAR, in a June 6, 1983, Business Week ad stated:

". . . Despite an uncooperative economy, railroad equities have tripled in market value. Obviously, America's freight railroads are a growth industry."

The railroads' continued citation of time-worn return on net investment statistics showing poor financial health is becoming increasingly difficult to support because of the ever-mounting evidence to the contrary. Merrill Lynch, for example, in its May, 1983 Railroad Industry Quarterly Update states:

"Thus far in 1983, railroad stocks, as measured by the Standard & Poor's Rail index, have turned in a strong market performance. During the first quarter of 1983, the S&P Rail Index was up 13.6 percent compared with an 8.9 percent advance in the S&P 500 Index: and, through May 18, the 1983 gain in the Rail Index was 35.4 percent while the S&P 500 Index was up 16.2 percent."

Merrill Lynch further states:

"The financial condition of the railroad companies that we follow has been improving, a fact that becomes more impressive considering the overall decline of financial strength of industry in general during the recession."

Nor is this trend a short term occurrence. Figure No. 3 compares the Standard & Poor's (S&P) Rail Index to the S&P 500 Index over the period 1976 through 1983. It can be seen that the Rail Index has outperformed the S&P 500 Index. In other words, an investment in railroad securities produces on the average a far greater yield than a comparable investment in industrial stocks.

Many other members of the financial community are voicing similar optimism about the rail industry. Table No. 4 displays the average annual price/earnings ratio of the coal-carrying railroad systems. The price/earnings ratio is a stock market oriented ratio that indicates the expected growth in profits. It can readily be seen how these ratios have substantially increased between 1979 and 1982.

Another key indicator of financial soundness is the ability of a company to generate its investment needs from internal cash flow. Table No. 5, listing the ratio of cash flow per share to capital spending per share for major coal-hauling railroad systems, shows that these railroads indeed have this capability.

Events during recent months vivdly illustrate the absurdity of the ICC's revenue adequacy findings. Last year the ICC determined that noe of the major rail carrier components of CSX was earning adequate revenues. How can it be that the principal railroad components of CSX have inadequate revenues when the parent holding company has offered to acquire the outstanding stock of Texas Gas Resources Corporation, including a major barge line, for an amount of about $1 billion?

The recent acquisition by the Burlington Northern of El Paso Natural Gas for about $600 million and the Norfolk & Western's bid for a significant share of Piedmont Airline also demonstrate the wealth amassed by a number of "revenue inadequate" coal hauling carriers and the increased availability to them of capital for investment.

It should be obvious that the majority of the nation's coal-hauling railroads do not need the unrestrained freedom given them by the ICC to maximize their profits from captive coal shippers. The application of a rule designed to aid the least profitable railroads to the entire industry is resulting in windfall gains for the traditionally healthy coal-carrying roads, at the expense of the consumers.

The correlation between the healthy railroads and the percentage of their coal trafffic is clear, but the ICC refuses to recognize this fact and persists, together with the Association of American Railroads, in speaking of an "industry" in poor financial health. Using the excuse that something must be done to help improve the financial health of the rail "industry", the ICC has interpreted the Staggers Act so as to emasculate the protections for captive shippers, culminating in its most recent decision in the Ex Parte No. 347 (Sub-No. 1) proceeding. This decision, particularly when applied in conjunction with the other recent ICC distortions of the Act, effectively removes any limitations on maximum rates. Ironically, the railroads that benefit the most from the ICC's decisions are those that need the help the least—the large coal-hauling lines.

Electric utilities have vigorously opposed the ICC's continuing efforts to free the railroads from effective regulation of their captive coal traffic. Our industry has participated at every stage of the Commission's major rulemaking proceeding on such key policies as railroad market dominance; rate ajustments to account for inflation-related cost increases; railroad revenue adequacy; and maximum coal rates. It has become apparent, however, that these proceedings are essentially meaningless as far as the ICC is concerned because of the predisposition of the Commission to decide every major policy issue so as to assure the railroads that they will be able to extract ever greater profits from their captive coal traffic.

The Commission has also frustrated atttempts to deal meaningfully with these issues by fragmenting its proceedings. For example, the Commission's perverse policies on railroad revenue adequacy underlie the Commission's latest decision on maximum rates (Ex Parte No. 347, Sub-No. 1). However, the Commission did not acknowledge at the time it established its new revenue adequacy standards (Ex Parte No. 393, served March 30, 1981) that the decision would be the foundation of its new "what the market will bear" maximum rate policy.

In a similar manner, the Commission has proposed new coal rate "constraints" in the Ex Parte No. 347 (Sub-No. 1) proceeding, but the critical methodology for determining the level of permissible rates was decided in another proceeding (Docket No. 36988, served February 17, 1983) and will be implemented in yet another notice of proposed rulemaking (Ex Parte No. 393: Sub-No. 1, served February 18, 1983). Furthermore, while its latest proposal purports to establish the constraints of the Long-Cannon management factors, the I.C.C. earlier frustrated the shippers' effort through rulemaking to develop Long-Cannon data or formulate methodologies for handling Long-Cannon criteria. This is in spite of the fact that proper consideration of these factors is mandated by the Act.

The effect of these tactics by the Commission is that shippers have been confronted with a sort of "regulatory shell game", in which the true import of what is at stake always has been, or will be, confronted in some other proceeding. In the meantime, the railroads' rates and their profit margins for captive coal traffic continue to escalate inexorably.

The remainder of our testimony describes certain of the principle actions the ICC has taken and how they have resulted in effective deregulation of rates for captive coal shippers.

THE ICC'S NEW COAL RATE GUIDELINES

Throughout most of its history the ICC used a number of criteria to determine maximum reasonable rates. After the Staggers Act was passed the Commission reopened the Ex Parte No. 347 proceeding to establish guidelines for coal rates throughout the nation. The Commission proposed new guidelines, including changing from the ratio to the ton/ton-mile method of allocating constant costs. When this proposal was attacked from all sides, the Commission undertook again to reformulate its guidelines and in February of this year published the latest version of its new maximum rail rate policy for captive coal traffic.

Under this policy—which the Commission calls a "constrained market pricing approach"—captive coal traffic would be subject to four "constraints". First, a coal shipper could not be charged more than the "stand-alone" cost of serving its traffic. Second, captive shippers would not be required to bear the cost of "obvious management inefficiencies". Third, carriers would generally not be permitted to increase their rates on captive coal traffic by more than 15 percent in a single year in addition to inflation. Fourth, at least until a rail carrier reaches "revenue adequacy", it would be free to increase its rates unless it violates one of the three constraints previously listed.

Although the ICC has asked for comments on this decision it is obvious that the Commission intends to apply the thrust of these policies not only in coal rate cases, but to other captive traffic as well. This is made clear by the recent reopening of several long-pending coal rate cases, with required submission of evidence under the recently proposed maximum rate guidelines prior to receipt of public comment.

None of the so-called "constraints" on coal freight increases will restrain the railroads from raising their rates for captive shippers to any significant degree. The Staggers Act directs the ICC to "assist" rail carriers in achieving "revenue adequacy" and defines this concept in terms of "honest, economical and efficient" management. The Commission is also directed by the Long-Cannon provisions of the Staggers Act (49 U.S.C. 10707a. (e)(B) and (C)) to consider evidence of three factors relating to railroad management pricing efficiency, namely, elimination of non-compensatory traffic; maximization of contribution from competitive traffic; and reasonable allocation of any resultant unavoidable revenue shortfall over the carrier's traffic mix.

The Commission's proposal to adopt its version of "stand-alone cost" as the principal criterion for determining the reasonableness of railroad coal rates is utterly shocking. In one of the few cases in which such "costs" have been introduced, it has been estimated by Chessie that its rates could increase under this standard from $13.00 per ton to $182.00 per ton and by Conrail from $10 per ton to $89 per ton. Moreover, the "constraint" proposed by the Commission, to allow rates to increase by 15 percent per year, after inflation, would allow the quadrupling of rail rates within ten years.

The key to understanding the motivation of the Commission in promulgating these new maximum rate standards is the ICC's endorsement of "Ramsey Pricing" as the proper analytical approach for establishing maximum reasonable rates. The essence of Ramsey Pricing is that traffic having the least elastic demand (i.e., captive traffic) is charged the highest rates and traffic having the most elastic demand (i.e., competitive traffic) is charged the lowest rates. It has been repeatedly demonstrated to the Commission by outstanding economists that this concept is totally unworkable in the context of regulation of rates for captive rail shippers and that it cannot be squared with the Commission's responsibilities to set maximum reasonable rates for captive traffic. Nevertheless, the Commission has embraced this concept. It has decided, in essence, that because a shipper has no alternative but to pay whatever a railroad asks, that shipper should pay this amount. Surely if Congress had intended that result, it would have simply so provided in 1980.

Because the Commission's stand-alone cost "constraint" accomplishes nothing in the way of limiting rail rates, the Commission necessarily must be relying on one of the other three "constraints."

The constraint of reaching "revenue adequacy" does not present any effective limitation either. As we will explain in more detail below, the Commission's perverse definition of "revenue adequacy" grossly inflates the railroads' revenue needs.

The third "constraint," the proposal to allow increases of 15-percent per year, above inflation—with any amount by which rate increases in a particular years fall short of the ceiling being added to the allowable 15-percent increases in subsequent years—allows grossly excessive rate increases. In addition this proposal flies in the face of the statute, which contemplates 4-percent annual increases for revenue inadequate carriers in excess of inflation.

This leaves the "constraint" of "obvious management inefficiency," i.e., the ICC's nod in the direction of the Long-Cannon provisions of the Staggers Act. What the Commission is really saying to a shipper is "if you manage to get the data from a railroad to prove that it is inefficient, I guess we'll have to take a look at it." But they go on to add that demonstrated inefficiency must be of such magnitude as to convert a revenue inadequate railroad into a revenue adequate one. Merely showing that a railroad could, for example, cut its revenue shortfall in half will not suffice, in the Commission's view. As the Commission stated:

". . . if it is demonstrated that a carrier is carrying certain traffic in another part of its system at below directly variable cost and, as a consequence, is sustaining a loss on such traffic amounting to $1 million over a given period, the remedy of lowering the rate to the jurisdictional threshold based on the existence of the 'inefficiency' would bear no relation to the 'wrong' if so lowering the rate would deprive the carrier of $2 million over that same period." [1]

Nor did the Commission leave any room for partial relief, for example, to the extent of the found inefficiency.

THE COMMISSION'S GUTTING OF THE LONG-CANNON PROVISIONS

In marked contrast to its distorted implementation of the market dominance, revenue adequacy and cost recovery provisions of the Staggers Act, the ICC has resisted requests to implement those provisions of the Staggers Act, commonly referred to as the Long-Cannon provisions (49 U.S.C. 10707a(e)(B) and (C)). These provisions, reflective of Congressional concern about possible abusive monopoly pricing of coal traffic, require in substance that in determining whether or not to investigate a rate increase and, even more significantly, in determining whether a rate is reasonable the ICC must consider revenue losses from noncompensatory traffic or the failure to maximize the revenues from marginal traffic and to further consider "the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues". The ICC must also consider the impact of a proposed rate or rate increase on the attainment of the national energy goals. These specific provisions are to be read in the light of the statutory requirement that revenue adequacy be determined "under honest, economical, and efficient management" (49 U.S.C. 10704(a)(2)).

Recognizing the obvious fact that the data necessary to make the Long-Cannon determinations is within the possession of the carriers, a group of utility coal shippers filed a petition for rulemaking with the ICC on December 11, 1981 (No. 38754, *Arkansas Power & Light Co., et al—Petition to Institute Rulemaking Proceeding—Implementation of Long-Cannon Amendment to the Staggers Rail Act)* in which they sought a determination of pertinent data and the formulation of standards for application of that data. In a decision served on December 3, 1982, the Commission refused to institute the rulemaking in order to require the nation's railroads to produce the necessary data to enable the Commission to formulate standards for implementating the Long-Cannon provisions. Instead, the Commission cast the impossible burden back on shippers to obtain data from the railroads through discovery in individual rate proceedings, as discussed above. Without the rulemaking and those data, a utility cannot show that excessive cross-subsidization is occurring and the Commission and a reviewing court are in no position even to consider this issue.

It is obvious now that the Commission refuses to implement the Long-Cannon provisions of the Staggers Act. Congress must require the Commission to do so.

THE COMMISSION'S REVENUE ADEQUACY DECISIONS

A fundamental error flowing from the ICC's perception that the railroads face a massive capital shortfall has been the Commission's adoption of a completely unrealistic definition of railroad avenue adequacy. There are many references to the concept of revenue adequacy in the Staggers act.[2] which, however, made no change in the earlier 4-R Act definition of that term. The definition is:

"revenue levels for rail carriers . . . that are adequate, *under honest, economical, and efficient* management, to cover total operating expenses, including depreciation and obsolescence, plus a reasonable and economic profit or return (or both) on capital employed in the business." [3] (Emphasis supplied).

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[1] See Docket No. 38946, order served June 23, 1983, page 10.

[2] For example, the extraordinary "zone of rate flexibility" rate increases that are provided for in 49 U.S.C. § 10707a(c) and (d), and that are available in addition to the increases to offset inflation, are primarily intended to benefit carriers that are not earning adequate revenues.

[3] 49 U.S.C. § 10704(a)(2).

Congress had before it during the Staggers Act debates a Commission determination of revenue adequacy in 1980, finding 13 of the Class I carriers revenue adequate. At that time the I.C.C.'s regulations required the Commission to consider all pertinent financial indicators in determining the carriers' revenue adequacy. These included (1) a return on net investment (as then defined) equal to the carriers' cost of capital (as then defined), (2) financial ratios indicative of a sound financial condition, and (3) the carriers' ability to raise sufficient funds for needed capital improvements as measured by funds flow analysis. The Commission specifically emphasized that a return on net investment equal to the cost of capital would be only one measurement, not the sole criterion, for determining revenue adequacy.

Congress chose not to change the Commission's definition of revenue adequacy. Nor did it provide any further direction to the Commission as to how it should determine whether railroads were earning adequate revenues.

Shortly after the Staggers Act was passed, the Commission announced its intention in Ex Parte No. 393 to repeal its prior regulations. Former Commissioner Clapp dissented from the proposed change and predicted that the Commission's new standards would guarantee that every rail carrier would be declared revenue inadequate. As shown on page 3 of the attached memorandum obtained from the Commission under the Freedm of Information Act (Appendix A to this testimony) the Commission's own professional staff also concluded that the return on investment standard should not be the sole test of railroad revenue adequacy. According to the Commission's staff, the investment and financial analysts they had interviewed unanimously opposed use of a single ratio to determine revenue adequacy.

Notwithstanding the views of its own staff and of the financial and investment community, the Commission proceeded to jettison its prior regulations and to embrace the "cost of capital" standard as the sole criterion for determining revenue adequacy. That is, a railroad would not be deemed revenue adequate unless it were earning a rate of return equal to its cost of capital. The Commission also decided it would include in the railroads' investment base unused and unusable assets and value track structures at original cost plus betterments. The Commission used the current market cost of new issue debt for all debt, even the embedded debt that was incurred at the much lower interest rates of prior decades, and included deferred taxes in its valuation of the investment base.

Since its adoption of new standards in 1981, the ICC has annually determined the repeated adequacy of individual railroads. Ignoring repeated protests by shippers, the ICC has continued to apply the spurious methodology in Ex Parte No. 393. Not surprisingly and as predicted, under the Commission's decisions none of the major railroads has been deemed revenue adequate ever since 1981. This includes highly profitable major coal hauling roads such as the Burlington Northern, CSX, and the Norfolk-Southern.

We have already discussed the absurdity of the result of the Commission's determinations. The reasons why the Commission reaches this result are several, including:

The ICC has never scrutinized any railroad's rate base to determine its appropriateness for use in a regulatory proceeding;

The accounting system used by the railroads is not comparable to the system generally accepted by all other industries and appears to produce lower levels of profitability;

The ICC has decided to calculate the railroads' debt costs on the basis of current rather than actual (embedded) costs; and

The ICC has included deferred taxes in the rate base.

On March 9, 1983, the Commission served another decision in the Ex Parte No. 393 (Sub-No. 1) proceeding seeking additional comments on a proposal that would radically change the method of evaluating the railroads' rate base by, among other things, implementing a new "inflation accounting" system for all railroad assets other than land. The Commission issued a related decision in Docket No. 36988, served February 17, 1983. This decision amends the ICC's Uniform System of Accounts for Railroad Companies to require use of depreciation accounting instead of betterment accounting for that portion of the railroad property accounts generally characterized as "track structures." This was an action that had been recommended to the Commission for years by the General Accounting Office and others. However, the Commission also decided to require that the historical cost of original track property be restated to equal the cost of the most recent replacement of that property. Future depreciation under the Commission's new accounting system would be based upon this restated cost. This write-up of track investment permits the railroads to recover through depreciation, costs which have already been recovered in full under the Commission's earlier betterment accounting system. Moreover, without any notice whatsoever, the Commission decided to apply a program of "inflation accounting" to track structures and, more generally, to all railroad assets other than land.

The effect of this "inflation accounting" is to create a hypothetical, inflated rate base derived from estimating the current cost of assets purchased years ago, and would allow the railroads to earn a return on money which they never actually spent. Nothing in the Staggers Act contemplates that the ICC would take such action.

Taken together, these and other actions by the Commission constitute a massive assault on the economic welfare of the consumers that must not be tolerated by Congress.

CONCLUSION

The nation's electric ratepayers need protection against the railroads' monopoly power over coal rates. The ICC is supposed to carry out the task of every agency that sets rates: to consider the facts in individual rate proceedings and to reach an equitable result in light of the various objectives of the law. Instead of doing that, the Commission decided that its mission is to raise the already high profits railroads receive from hauling coal. Though cloaked in the verbiage of pseudo-economic theory, the Commission's policies at bottom simply allow the coal-hauling railroads to charge whatever they think the market will bear. This is an abdication of the Commission's responsibilities and no amount of economic mumbo-jumbo can convert this into a policy that complies with the ICC's statutory mandate to protect the consumer. The ICC has become a financial consultant to the coal-hauling railroads, not a regulator. It is now up to Congress to direct the ICC to protect the consumer from the abuse of unregulated monopoly exploitation.

FIGURE NO. 1

Coal Revenues Yield a 32.6 Percent Operating Profit While Other Traffic Only Yields 18.6 Percent On a Per Ton Basis

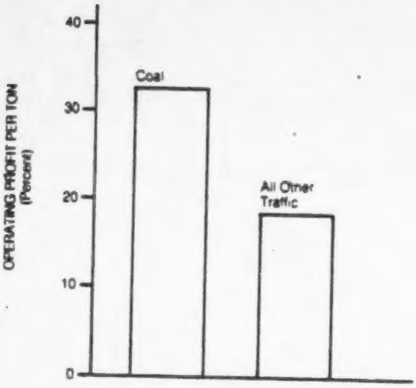

FIGURE NO. 2

Coal Revenues Yield a 32.7 Percent Operating Profit while Other Traffic Only Yields 18.5 Percent on a Ton-Mile Basis

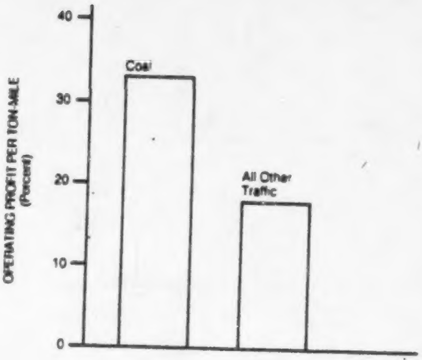

FIGURE NO. 3

S&P's Rail Index v. S&P 500 Index

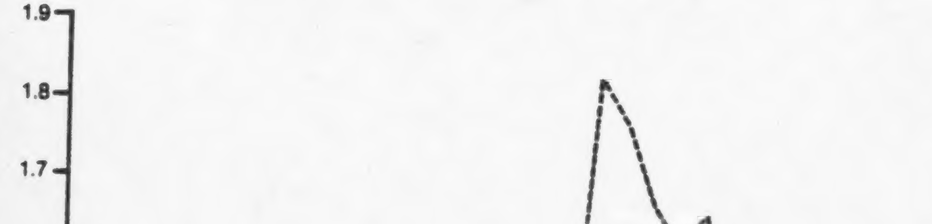

TABLE NO. 1.—1982: COAL REVENUE AND COST PER TON COMPARED TO OTHER TRAFFIC

Commodity (1)	Revenue per ton (2)	Cost per ton (3)	Operating profit (percent) (4)
Coal	$12.04	$8.11	32.6
Other Traffic	27.11	22.06	18.6

Source: Column 2: Interstate Commerce Commission, Freight Commodity Statistics. Colume 3: Relative level of profitability for coal and other commodities, developed from evidence submitted by the railroad defendants to the ICC in Docket Nos. 37063 and 37276. These relationships were applied to the 1982 traffic characteristics from ICC Freight Commodity Statistics.

TABLE NO. 2.—1982: COAL REVENUE AND COST PER TON-MILE COMPARED TO OTHER TRAFFIC

Commodity	Cents per ton-mile		Operating profit (percent)
	Revenue	Cost	
(1)	(2)	(3)	(4)
Coal	2.72	1.83	32.7
Other traffic	5.19	4.23	18.5

Source: Column 2: 1982 ICC Freight Commodity Statistics and 1981 TD-1 (Average Haul). Column 3: Relative level of profitability for coal and other commodities, developed from evidence submitted by the railroad defendants to the ICC in Docket Nos. 37063 and 37676. These relationships were applied to the 1982 traffic characteristics from ICC Freight Commodity Statistics.

TABLE NO. 3.—RAILROAD COAL RATES PER TON-MILE HAVE INCREASED IN CONSTANT DOLLARS

Year	Average current rate per ton-mile (dollars)	Railroad inflation (percent)	Average constant (1976) rate per ton-mile (dollar) [1]	Average coal haul	
				Miles	Index
	(1)	(2)	(3)	(4)	(5)
1976	$0.0165	100.0	$0.0165	320	100.0
1977	.0151	105.0	.0144	395	123.4
1978	.0181	108.9	.0166	381	119.1
1979	.0207	116.6	.0178	388	121.3
1980	.0226	126.9	.0178	418	130.6
1981	.0251	138.6	.0181	443	138.4
Percent of total increase	52		10		

[1] Column 1 divided by column 2.

Source: Column 1: Interstate Commerce Commission, Carload Waybill Statistics, Report TD-1. Column 2: Railroad inflation measured by change in Total Cost Per Unit of Output, 1976-81. Column 4: Interstate Commerce Commission, Freight Commodity Statistics.

TABLE NO. 4.—AVERAGE ANNUAL PRICE/EARNINGS RATIO FOR COAL HAULING RAILROAD SYSTEMS

	1976	1977	1978	1979	1980	1981	1982	July 6, 1983
CSX (Chessie/Seaboard)	6.9	9.2	8.5	4.8	5.0	5.8	5.8	9
Norfolk Southern	6.6	9.0	7.5	3.9	4.8	5.2	7.6	11
Burlington Northern	7.3	7.9	4.6	3.9	5.6	8.0	6.4	15

Source: Value line: Railroad Industry, April 8, 1983; Railroad Resource Industry, May 20, 1983; the Washington Post, July 7, 1983. Definition of terms: Average Annual Price/Earnings Ratio—the average price of the stock for the year divided by earnings per share as reported by the company for the year. In the case of fiscal year companies, all data are for the fiscal year.

TABLE NO. 5.—RATIO OF CASH FLOW PER SHARE TO CAPITAL SPENDING PER SHARE FOR COAL HAULING RAILROAD SYSTEMS

	1976	1977	1978	1979	1980	1981	1982	1983 est.
CSX (Chessie/Seaboard)	0.72	1.03	0.65	1.21	0.79	0.98	1.58	1.88
Norfolk Southern	1.76	2.20	1.41	2.25	1.87	2.82	1.66	3.02
Burlington Northern	0.86	0.59	0.80	0.79	0.83	0.97	1.31	0.82

Source: Value line: Railroad Industry, April 8, 1983; and Railroad Resource Industry, May 20, 1983.

Definition of terms: Capital Spending Per Share—the outlays for plant and equipment for the year expressed on a per share basis. Cash Flow Per Share—net profit plus non-cash charges, (depreciation, depletion, and amortization), less perferred dividends (if any), divided by common shares outstanding at year end.

APPENDIX A

INTERSTATE COMMERCE COMMISSION

MEMORANDUM

To: Director Young.
From: Ward L. Ginn, Acting Chief, Section of Financial Analysis.
Subject: Ex Parte No. 393, Standards for Railroad Revenue Adequacy.

CONCLUSION

We recommend use of the Return on Investment as a primary economic measure of revenue adequacy in conjunction with those financial ratios relied upon by the investment community to evaluate the current financial strength of railroads. The most important and widely used of these are:

Operating Ratio (OR).
Net Cash Flow (NCF).
Fixed Charge Coverage (FCC).
Throw Off to Debt (TOTD).
Dividend Payout Ratio (DPR).
Return on Equity (ROE).
Return on Total Capital (ROTC).

We believe these ratios provide a sound basis for measuring the current financial health of the railroads and will supplement and modify the historical perspective gained from the use of Return on Investment.

We applied the preceding ratios (with one exception) to the 35 Class I railroads and compared the results with conservative and generally accepted guidelines of adequacy for each ratio. It was determined that four railroads met all ratio tests for adequacy, while another eight railroads were adequate, or nearly so, on all but one or two ratios. The remaining twenty-three railroads were deemed to be revenue inadequate.

The one ratio which could not be applied in our analysis due to time constraints and lack of complete data was the Net Cash Flow. The NCF is considered by the investment community as a key indicator of revenue adequacy since it measures a railroad's ability to cover current and prospective needs for funds, without relating those needs to the "sunk" costs embedded in the existing railroad plant. We recommend that this funds flow approach be emphasized in the future annual determinations of revenue adequacy.

The following sections discuss the ratios employed as they relate to each requirement of the Stagger's Rail Act, and the results obtained for each railroad. Appendix A describes methods of analysis used by twelve leading investment analysts specializing in the railroad industry.

COMMENTS

The Commission is required, under Title 49, 10704(a)(2) of the United States Code, to determine which railroads are receiving adequate revenues, as defined in that section.

We propose that the determination be made, in so far, in accordance with the procedures employed in previous proceedings held to determine revenue adequacy. In Ex Parte No. 353, *Adequacy of Railroad Revenue (1978) Determination)* a combination of financial ratios and funds flows analysis was used. In the instant proceedings funds flows analysis cannot be employed due to the time constraints legislatively mandated and the unavailability of complete data.

The following table indicates which ratios were selected to satisfy each requirement to determine revenue adequacy as defined in Title 49 (supra).

REVENUE ADEQUACY STANDARDS

Requirements of title 49, section 10704 (a) (2) of U.S. Code	*Appropriate financial ratio*
1. Cover total operating expenses, including depreciation and obsolescence.	Operating ratio.
2. Provide a reasonable and economic profit or return (or both) on capital employed in the business.	Return on investment (ROI). Return on shareholders' equity (ROE). Return on total capitalization (ROTC).
3. Provide a flow of net income plus depreciation adequate to support prudent capital outlays.	Percentage of increase in net transportation investment.
4. Assure repayment of a reasonable level of debt.	Throw-off-to debt ratio (TOTD). Fixed charges coverage ratio (FCC).
5. Permit raising of needed equity capital...	Return on shareholders' equity.
6. Cover effects of inflation..............................	Comparison of ROI to cost of capital.
7. Attract and retain capital in amounts adequate to provide a sound transportation system.	ROI, ROE, ROTC and dividend payout ratio.

These ratios were developed for each of the 35 Class I railroads using the most recent available data which was for the year 1979. The ROI standards for after tax return developed in Ex Parte No. 363, 1979 *Railroad Revenue Adequacy Determination* were used. Those standards indicate that the ROI range from 11 percent using 1979 embedded debt rates and 11.7 percent using 1979 current debt rate.

While ROI, or cost of capital, is an important, if not primary, indicator of an enterprise's economic well-being, its application to railroads is not wholly appropriate and should not solely govern determination of revenue adequacy. The railroad industry is a mature industry with no significant prospects for expansion or diversification and no major needs for infusions of fresh equity capital for those purposes. In fact, it is generally acknowledged that the need exists for rationalization of the industry through a substantial contraction of its physical plant.

The capital needs of the industry, therefore, are significantly different from growth industries or those in a condition of stability. The primary capital needs of the railroads are for maintenance of plant and replacement of obsolete equipment. These needs have been met in recent years entirely through the issuance of debt or quasi-debt (cumulative preferred stock) instruments and through the reinvestment of retained earnings.

It follows, that revenues sufficient to cover operating expenses, maintain plant and equipment, cover debt costs, pay dividends and provide reasonable retained earnings demonstrates revenue adequacy. These are the elements considered most carefully by the investment community and are well expressed in the conclusions readied by the firm of Printon, Kane Research, Inc. which read, in part, as follows:[1]

". . . there is no one figure or composite of figures which can pinpoint precisely a quality rating. Judgment must be exercised and should be based not only on statistical data pertinent to a company, but also on the environment in which the industry as a whole is operating and the intangible factor of management capabilities.

"Conventional analysis of rail equities is grounded in earning power as measured by earnings per share, dividends, and dividend payout ratios. Methods for measuring the quality of earnings include capitalization factors, expense ratios, effective tax rates, and sources of non-rail income, if any. Operating characteristics, as indicated by the traffic mix, traffic density, productivity of labor, and efficiency of train and yard operations also are used as analytical tools. Cash earnings per share are of some interest to investors but are not necessarily reliable approximations of cash available to pay dividends, retire debt, and finance future growth.

"Another approach to the evaluation of railroad equities is one based on a rate of return concept. A rate of return analysis would supplement the foregoing analytical tools and add a qualitative element by focusing on the interrelationship between the income account and the balance sheet; i.e., the relationship between sales growth and cost control on the one hand and asset investment and management on the other hand. Such an analysis highlights key operational factors as well as financial strengths and weaknesses. For the long term investor, it can add a new perspective to the understanding of past corporate changes and give a clearer indication of the future."

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[1] Railstat 1980 pp. 14–15, Printon, Kane Research, Inc., 153 E. 53 St., N.Y., N.Y. 10022.

As we previously indicated, funds flow data is very limited in the instant proceeding. Therefore, financial ratios utilizing funds flow concepts must be examined. These include:

Return on equity (ROE)—ROE is compared to the 13.5 percent cost of equity capital employed in Ex Parte No. 363. However, this 13.5 percent figure is most appropriate for new investment decisions (e.g. unit coal train operations) and is given relatively little weight in our evaluations of revenue adequacy.

Return on Total Capitalization (ROTC)—ROTC is likewise given lesser weight in revenue adequacy proceedings than in new investment decisions. The ROTC is roughly compared to the same standards used to measure ROI.

Throw-off-to-Debt (TOTO) and Fixed Charges Coverage (FCC) Ratios—These ratios are given heavy weighting by the financial community in their evaluation of the financial condition of the railroads. Since debt financing is extremely important to the railroads, these ratios are accorded considerable weight in our evaluations of revenue adequacy. As a standard or guidelines, we have considered 3.5 times coverage to be adequate. This figure is considerably higher than the figure utilized by Standard and Poor (2 times) but we feel that conservative figures minimize the chances of misevaluations revenue adequacy. In some cases, a railroad might be considered revenue adequate even with ratios slightly below 3.5 times.

Operating Ratio (OR)—This is another ratio accorded considerable weight by both the investment community and in our evaluations. An operating ratio over time of 8.5 percent is a strong indication that a carrier is adequately covering its operating expenses and may have adequate revenues.

Dividend Payout Ratio (DPR)—This ratio indicates the percentage of net income paid in dividends as opposed to being retained in the business. The railroad industry has paid out a substantial portion of net income in dividends, a normal occurrence for a contracting industry. Comparison of dividend payouts to the net increase in railroad investment provides an indication of whether a railroad is earning revenues adequate enough to compensate its equity holders and still cover necessary plant and equipment expenses.

Using these tests, our evaluations reveal that four carriers have adequate revenues based on ROI equal to cost of capital. These carriers are the Bessemer & Lake Erie; Elgin, Joliet & Eastern, Clinchfield; and the Fort Worth & Denver. Four additional carriers have ROI's below the cost of capital rate but have ROE, ROTC, TOTO, FCC, and operating ratios that are better than the respective standards. These carriers are the Norfolk & Western; Florida East Coast; Souther; and the Soo Line. Finally, four more carriers have ROI, ROE, and ROTC somewhat below standard but have an overall financial position suggesting revenue adequacy. These carriers are the Denver & Rio Grande Western; Missouri Pacific; St. Louis-Southwestern; and the Union Pacific. The remaining 23 carriers have inadequate revenues at the present time.

EX PARTE NO. 393 STANDARDS FOR RAILROAD REVENUE ADEQUACY

We have telephoned a number of analysts in the investment and financial community concerning their views or appropriate criteria for determining revenue adequacy for railroads.

While various analysts emphasized one financial ratio over another, there was unanimity of views on two points:

(1) No single ratio should be employed as the sole determinant of revenue adequacy.

(2) Each railroad should be considered separately since financial ratios alone may not disclose all factors affecting revenue adequacy, e.g., extent of deferred maintenance, proposed capital expenditures, and degree of competition.

Following is a summary of the views each analysts as expressed in our telephone conversations: Richard H. Fischer, Vice President, Merrill Lynch, 212-637-8157.

Considers the most significant ratios to be the operating ratio, transportation ratio and maintenance ratio, but would also examine other standard financial ratios such as ROE, pre-tax fixed charges coverage ratio, and debt/equity ratio: Thomas Donnelly, Vice President, Morgan Guaranty Trust, 212-826-7447.

Considers operating ratio, fixed charge coverage, pre-tax margin of profit, return on equity and debt/equity ratios (compared to other railroads) as the most indicative of a railroads financial health. Would use a 5 or 6 year time horizon in evaluating the operating ratio: William Blanchfield, Metropolitan Life, 212-578-2858.

Considers fixed charge coverage, return on equity, operating ratio, debt/equity ratio, and transportation ratios as the prime measures of financial risk. Does not consider railroads as prime financial risks: Isable Benam, 212-355-0155.

Cities aftertax return on total capital, return on equity, debt/equity ratio, net railroad operating rates as a percent of gross revenues, and ordinary income as a percent of gross revenues, as, perhaps, the key ratios but also uses others. She offered to mail us (for loan) book describing and apply the formulas which she uses in her analyses. Henry Livingston Kidder Peabody, 212-747-2804.

Emphasizes not cash flow after all expenses. Operating ratio also considered important. Considers return on investment misleading because of the absolescence and over capacity built into the investment base. Also would review dividend growth rate and net growth in investment as significant factors in evaluating railroads: Anthony Low-Beer, L. F. Rothschild, 212-425-3300.

Uses cash flow compared to operating revenues as a primary measure. Cash flow is defined as net income plus depreciation, deferred taxes and salvage income less serial debt payments (equipment trust certificates) and sinking fund payments. Considers maintenance ratio important. Estimates that only three major railroads have adequate revenues, the Southern, Union Pacific and Norfolk and Western. To mail his revent review of the railroad industry: Robert Long, First Boston Corp., 212-825-7376.

Considers four ratios to be of prime importance: return on investment, operating ratio, fixed charge coverage and cash flow ratio computer by comparing net cash flow to dividends paid plus scheduled capital expenditures. Norfolk and Western is the only railroad with a positive and flow applying this test: Michael Epstein, Partner, Salomon Bros., 212-747-7423.

Primarily interest in debt securities. Uses pre and after tax interest coverage. Also return on investment computed by calculating NROI as a percent of operating property. Gives weight to the debt/equity ratio and uses a time horizon of 3-5 years. The only debt securities (other than Equipment Trust Securities and Capitalized Leases) recently issued was a bond issue by the Burlington Northern in July 1980. ETC's customarily pay 40 to 100 basis points above U.S. Treasuries with comparable maturities: Frederick McMalon, Moodys, 212-533-0367.

Basically applies a variety of ratios to the income statement, balance sheet and statement of changes in financial condition, however primary emphasis is on income coverage of debt service costs. Long term debt service cost is close to that of other railroads: Sally Smith, Security Analyst, Alexander Brown and Sons, 361-2820.

Principal ratios employed are the operating ratio, wage rates to total expenses and revenues, transportation ratio, debt/equity ratio, pre-tax interest coverage. Also computes revenue per ton mile and revenue per employee for comparison with other railroads: James Sullivan, Falmstock & Co., 482-6330.

Considers positive net cash flow as an essentical measure. Examines commodity relatives to general economic environment and prospects. Compares net income less dividends to maturing long term debt, lease and interest payments. Consider 2:1 a sound ratio. ROI is useful for interroad comparisons: John J. Cirigliano, Vice President, Michael Reilly; Merrill Lynch.

Employ funds flow analysis. Develop incremental cost of capital assuming 20 percent Equipment Debt, 30 percent Mortgage Debt, 50 percent Equity using current actual cost. Equity cost is considered to be the diverse of the price/earnings ratio. The Realized Cost of Capital is computed by adding pre-tax income, interest expense, depreciation and principal payments and dividing the sum by total capitalization, excluding deferred taxes. If the Realized Cost equals or exceeds the Incremental Cost the railroad is considered revenue adequate.

The following paragraph is abstracted from the statement No. 12 filed 1/21/81 in the instant proceeding: James A. Rwrde, Vice President, Morgan Stanley & Co., Inc.

Proposes replacement cost as investment base. Applies four tests to measure revenue adequacy.

1. Return on Equity,
2. Long term debt to total capitalization (30 percent),
3. Pre-tax fixed charge coverage (4.4),
4. Net cash flow as percentage of long term debt (66 percent).

Above ratios are compared to single A rated industrial ratios.

MEASUREMENT CRITERIA FOR EVALUATING R.R. REVENUE ADEQUACY TELEPHONE SURVEY RESULTS FROM VARIOUS ANALYSTS—CRITERIA USED

Firm	Miscellaneous Other (See Below)	Operator ratio	Fixed Charge coverage	Net cash flow	Debt/equity ratio	Return on equity	Transportation ratio	MTCE ratio	Return on Investment
First Boston		X	X	X					X
L. F. Rothschild				X				X	
Merrill Lynch		X					X	X	
Metro. Life		X	X		X	X	X		
Printon Kane Research	(1)					X			
Kidder Peabody	(2)	X		X					
Morgan Guaranty		X	X		X	X			
Alexander Brown	(3)	X	X		X		X		
Moodys	(4)		X	X					
Salomon Bros.			X		X				X
Fahnestock & Co.			X	X					
Morgan Stanley			X	X	X	X			

(1) Return on total capital NORI ratio to total revenue ORD income to total revenue.

(2) Dividend growth net investment growth.

(3) Wage ratio: Revenue per ton mile, revenue per employee.

(4) Various unspecified.

SEPARATE STATEMENT OF ARTHUR J. DOYLE, CHAIRMAN OF THE BOARD AND PRESIDENT, KANSAS CITY POWER & LIGHT CO.

Mr. Chairman, and members of the Committee, I am Arthur J. Doyle, Chairman of the Board and President of Kansas City Power & Light Company (KCPL). Today I appear before you on behalf of Edison Electric Institute (EEI), an association of the nation's investor-owned electric utilities. As an industry, we are concerned that the Staggers Rail Act of 1980 is not achieving the objectives established therein by the Congress because the Interstate Commerce Commission (ICC) has, by its rulings and decisions, subverted the letter and the intent of that law. The broad concerns of our electric utility industry have been expressed in our testimony prefiled on behalf of EEI.

This separate statement filed on behalf of KCPL will provide some specific examples of how the Staggers Act, as currently being implemented by the ICC, is adversely impacting our electric customers contrary to the intent of the Congress as expressed in the Staggers Act.

KCPL'S COAL AND RAIL TRANSPORTATION REQUIREMENTS

KCPL is a midwestern electric utility serving some 350,000 customers in western Missouri and eastern Kansas, with annual electric revenues of approximately $500 million. Coal accounts for more than 96 percent of the total Btu's of fuel required to meet the electric needs of our customers. As shown in the attached fact sheet, in 1983 we expect to burn nearly 8.8 million tons of coal, which includes 5.2 million tons for KCPL's own customers and 3.6 million tons for the customers of partners in jointly owned generating units operated by KCPL. Thus, our total coal burn for 1983 will represent about 1.5 percent of all the coal that will be burned by U.S. electric utilities in 1983 to meet the electric needs of the public.

KCPL's coal and rail transportation costs for coal for its customers' needs are a significant portion of our total cost of electric service, representing about 35 percent of KCPL's total operating expenses. For our customers alone, our 1983 rail freight bill for coal will amount to more than $50 million or more than $140 per year per customer.

Nearly 6.5 million tons of KCPL's total 8.8 million ton coal burn in 1983 will be delivered by rail, and its rail transportation bill will amount to nearly $90 million. Those rail freight costs currently average more than 60 percent of our total delivered cost per ton of western coal which is transported in shipper owned and maintained unit trains comprised of about 110 cars of 100 tons capacity each.

KCPL: A CAPTIVE COAL SHIPPER

KCPL is a captive rail shipper with respect to most of that nearly $90 million per year total freight bill for the transportation of coal. Specifically, over 90 percent of our coal delivered by rail is western low sulfur coal from the Hanna and Powder River Basins in Wyoming. Railroads are the only current means available for transporting that western coal the some 750 to 900 miles to Missouri and Kansas generating units. The Hanna Basin is served exclusively by the Union Pacific, while the Burlington Northern is the sole carrier of Powder River Basin coal. Neither of these railroads faces any existing competition from other railroads, or other means of coal transportation; consequently they enjoy a total monopoly on this coal traffic.

KCPL supports the development of coal slurry pipelines because the competition provided would help hold down rail transportation costs, and ultimately electric rates. However, as this Committee is aware, the slurry pipeline is far from a reality, and certainly offers no promise for the near-term future. Attempts by a proposed competing railroad (Chicago & Northwestern) to ship Powder River Basin coal have been frustrated to date by Burlington Northern legal challenges. KCPL's dependence on western coal delivered to it by these monopolistic rail carriers will in all probability increase in the future because of our need for additional low sulfur coal.

THE STAGGERS ACT: REVENUE /VARIABLE COST RATIO SUBVERTED BY ICC

Recall that the Staggers Act, in its attempt at partial deregulation of the railroad industry, established certain rate tests by which exercise of continued ICC jurisdiction was to be determined. One of those rate tests was the "threshold" or jurisdictional limit measured by the ratio of the railroad's proposed revenue to "variable costs" for the movement. Revenue/variable cost ratios at or below the threshold level are presumed reasonable and the proposed rates not subject to further ICC jurisdiction. Beginning at the 160 percent (or 1.6 to 1) ratio level, the threshold increases in increments of 5 percent per year until 1984, when the ICC is given authority to "reestablish" a new statutory maximum. The current limit is 170 percent, or 1.7 to 1. A "zone of flexibility" for rate increases is also permitted, but it allows the ICC to investigate proposed rates when the resulting revenue/variable cost ratio is 20 percentage points or more above the threshold limit.

Railroads and their shippers have long differed on what constitutes a railroad's "variable costs" for a rail movement, and the ICC has recently, since passage of the Staggers Act, proposed uniform rail accounting system changes which would now, by definition, assign a greater proportion of the railroads' total system costs from "fixed" to "variable" costs. Thus, by inreasing the base "variable cost" for a rail movement by an accounting change, the ICC would frustrate the intent of Congress in fixing the specific statutory threshold limits for ICC jurisdiction under the Staggers Act.

ICC'S BLINDED FOCUS ON "REVENUE ADEQUACY"

The Staggers Act provides specific safeguards for the protection of captive coal shippers, such as KCPL, by requiring the ICC "to maintain reasonable rates where there is an absence of effective competition . . ." (para. (6) of Section 101(a) of the Staggers Act). Congress clearly intended for such protection to be maintained, stating in the joint report announcing passage of the Staggers Act:

"The Conferees intend that this policy include the encouragement and promotion of the transportation of coal by rail in accordance with the objective of energy independence *at rates which do not exceed a reasonable maximum where there is an absence of effective competition.* (HR Report No. 96–1430, dated 9/29/80, Title 1, at p. 80.)" (Emphasis added.)

The ICC's abdication of its regulatory responsibility under the Staggers Act has been blatant. Earlier this year, KCPL protested a proposed increased freight rate filed by Burlington Northern for Powder River coal deliveries to one of our generating stations and we requested ICC suspension and investigation of that proposed rate increase. In its April 6, 1983, Order (Suspension Case No. 71003; copy attached), the ICC stated:

"This record does not permit an accurate restatement of the carrier's cost of providing the service, but *we can determine* that the rate results in a revenue-variable cost percentage that is *no less than* 20 percentage points *above* the 170 percent revenue-variable cost currently applicable under 49 U.S.C. 10709(d) and that it may reflect a revenue-to-variable-cost ratio as *high as 2.15 to 1. A revenue-to-variable-cost relationship of this magnitude does not, in our judgment, warrant instituting an investigation.*" (Emphasis added.)

Thus, although the ICC itself determined that the revenue/variable cost ratio was at least 190 percent, and perhaps as high as 215 percent—each at or above the threshold plus the zone of flexibility limits—the ICC nevertheless refused to exercise its jurisdiction to regulate the rate. Furthermore the ICC summarily held in this case that the proposed rate was "reasonable," stating:

"We have determined rates to be reasonable that produce revenue-to-variable-cost ratios as high as or higher than those involved here especially where considerations of revenue adequacy were significant. BN is a revenue inadequate carrier."

The ICC is now using a single measure of "revenue adequacy" which finds that none of the Class 1 railroads in the United States is revenue adequate. The ICC's new test of "revenue adequacy" is current cost of capital applied to net investment including deferred tax reserves. In calculating the railroads' cost of capital the ICC uses the current market cost of new debt for all debt, even the railroads' embedded debt which was incurred at much lower interest rates.

Prior to the Staggers Act, the ICC in early 1980 concluded that some 13 of the 36 Class 1 railroad were revenue adequate. But under the ICC's new test adopted after the Staggers Act, all Class 1 railroads, including the UP and the BN, are now found by the ICC to be "revenue inadequate". Based on its new test of "revenue adequacy," the ICC is now refusing to suspend and investigate proposed rates which substantially exceed the threshhold revenue/variable cost ratios, as fixed by Congress, to assure reasonable maximum rates in the absence of effective competition. By focusing only on "revenue adequacy," the ICC is now blind to other provisions of the Staggers Act which Congress designed to protect the public, such as our electric ratepayers, where a captive shipper, such as KCPL, has no bargaining leverage against monopolistic rate increases by railroads operating without effecive competition.

ICC CONSTRAINTS WITHOUT RESTRAINT

Absent Congressional intervention, the prospects for even further and continued unwarranted coal freight rate escalations appear likely. In its February 1983 policy statement contained in Ex Parte No. 347, the ICC proposed new rate guidelines which would allow railroads to charge any rate they desire on coal traffic, subject only to the following "constraints":

(1) Rates may not exceed a level equal to the "stand alone" cost of service. This calls for the calculation of the long-run costs for the capacity of rail plant and depreciation required by the stand alone shipper with all assets valued at current replacement costs—not the true costs to the railroad of providing the service.

(2) Annual rate increase of up to 15 percent per year, after inflation are permitted with unused prior year increase subject to carryover.

(3) Captive coal rates will not be required to cover costs attributable to "obvious management inefficiency." However, the ICC has adopted no method for measuring managerial efficiency.

(4) As long as a carrier is not "revenue adequate" under the ICC's new definition it may raise rates unless it would violate one of the above "constraints."

Application of those ICC "guidelines" to KCPL's coal movements would result, over just the next five years, in increasing KCPL's current annual coal freight cost of $50 million to more than $135 million per year to its own customers. In other words, application of these ICC "guidelines" would nearly triple KCPL's cost per customer per year for rail transportation charges as reflected in their electric bills.

Although the ICC has characterized the Ex Parte No. 347 guidelines as merely "proposed guidelines," KCPL was recently directed by ICC Order to file evidence consistent with the "guidelines" in a case pending since 1979. (ICC Docket No. 36401) Although the Staggers Act was designed to hold rates for captive coal shippers at reasonable maximum levels, it is apparent that the ICC believes the burden of improving the financial condition of the railroads should be carried largely and quickly by those electric utilities (and their customers) that are captive railroad shippers, as typified by its statement in the Ex Parte 347 decision:

We believe that maximum rates on market dominant traffic, in general, should be permitted to increase to the extent necessary for a carrier to achieve revenue adequacy. As discussed below, however, this does not mean that further rate increases on captive coal traffic would be unreasonable per se once a carrier attains revenue adequacy.

In fact and reality the ICC's Ex Parte 347 proposed "guidelines" which are being implemented are "constraints without restraint".

KCPL SUMMARY POSITION

Based on its own experience, KCPL as a captive coal shipper has found that under the Staggers Act as being implemented—

1. The ICC proposes to subvert the intent of the Congress as expressed in the Staggers Act by an accounting change, significantly increasing the threshold limits of its jurisdiction based on the statutorily-fixed revenue/variable cost ratios. By new definition, railroad costs previously characterized as "fixed costs" would be shifted to "variable costs".
2. The ICC is now applying a new test of "revenue adequacy" which is different than that it applied immediately prior to the passage of the Staggers Act and as a result all Class 1 railroads are now found by the ICC to be "revenue inadequate".
3. The ICC is authorized to investigate railroad rate increases that result in a revenue/variable cost ratio that is 20 percentage points or more greater than the current statutorily imposed 170 percent jurisdictional threshold for captive shippers (i.e., at least 1.9 to 1). However, the ICC has refused to investigate a rate increase producing a revenue/variable cost ratio as high as 2.15 to 1 based on its finding that all Class 1 railroads are "revenue inadequate" under its new method of determination.
4. The protection designed by the Staggers Act for captive coal shippers under the criteria of "reasonable maximum rates" is being ignored by the ICC based on its new finding of railroad "revenue inadequacy".
5. The ICC's Ex Parte No. 347 "guidelines" although characterized by the ICC as "proposed" are currently being applied to captive coal shippers who are now required by the ICC to file evidence consistent with such "proposed guidelines."
6. The ICC's proposed Ex Parte No. 347 "guidelines," if permitted by the Congress to be applied by the ICC in abdication of its Congressional mandate under the Staggers Act, would result within 5 years in nearly a tripling of KCPL's rail charges for coal which must be reflected in our electric service rates of the public.

It is imperative that the Congress exercise its oversight authority to correct and prevent the ICC's circumvention of the intent of the Congress as expressed in the Staggers Act and the Committee reports which accompanied it.

STATEMENT OF CONSUMER FEDERATION OF AMERICA

My name is David Greenberg and I am Legislative Director of Consumer Federation of America with offices at 1314 14th Street, NW, Washington, D.C. 20005.

The Consumer Federation is the nation's largest consumer advocacy organization with a membership encompassing more than 200 national, state and local groups committed to the goals of pro consumer policy. Its affiliates represent some 30 million consumers. In this proceeding, it represents the interests of the electric ratepayers of this nation, who ultimately bear the burden of railroad coal rate increases either in higher electric bills or in decreased electricity usage for necessary heating and cooling.

Although the Consumer Federation has historically been actively involved in many areas of electric rate regulation, it has not heretofore participated in the Interstate Commerce Commission coal rate guidelines proceeding because until relatively recently the Commission's actions have attempted to provide some balance between the interests of carriers, shippers and the consuming public.

Now, however, the I.C.C.'s latest proposal with respect the domestic coal rates would allow the railroads to charge whatever they want on their captive traffic, without regard to the interests of the public and shippers. Many utility companies have taken up this challenge, I am happy to say, but they—and we—are preordained to lose under this proposed standard.

Coal is certainly an apparently easy target for monopolistic railroad rate increases, if they are permitted, and this is particulary true of utility coal used to generate electricity. First, increasing amounts of it are being used in the interests of promoting the nation's energy independence. Secondly, under Clean Air Act standards, proper quality coal must be obtained from greater distances. In the period 1976 to the present, the average coal haul distance has increased by approximately 50 percent. That makes the utility shippers—if it is possible—even more captive to the railroads because, as distances increase, the potential for use of alternative modes of transportation, such as trucks, declines. This Commission itself has found that a large majority of utility coal is captive to the railroads and will be for years to come.

Captivity should be an indication of the need for I.C.C. protection. Instead, the Commission has essentially deregulated domestic coal traffic. It has, it is true, written a long and complex justification for its proposal, but its essence is clear. Since it will take 15 or more years for utilities to retire their presently captive plants, the railroads have that 15 year period in which to charge "what the market will bear" on the coal traffic destined for those plants. Under the Commission's proposal, if rail rates are increased according to the permissible 15 percent per year above inflation, this will generate more additional revenues to the railroads than their entire present net worth. In other words, it might be more to the advantage of this nation's consumers to buy the railroads today than to pay those rates in their utility bills.

The railroads respond that they have been circumspect in their rate actions recently. Past actions, particularly during a recession, are not the issue. The issue is what the I.C.C. proposes to permit in the future. Although the Commission has left some considerable vagueness in its proposal, the thrust appears to be to let coal rates rise to the level at which the shipper would go elsewhere for service or provide that service itself.

In the case of the captive utilities which depend upon rail transportation, and generally upon a single carrier at origin and/or destination or both, this means the level at which the utility could build its own railroad. It would be like permitting a utility to raise its rates to the level at which the consumer could for the same outrageous price install his own generator in his back yard. In simple terms, what the Commission is proposing is to aid its regulated industry in determining what is the optimum monopoly price for its services.

In this proposal the Commission has overturned all of its prior regulatory practice and precedent which for a century has been based upon traditional (albeit increasingly refined) cost measures of rate excesses. Under the law up until this ruling, rates were measured in one form or another against the costs of providng the particular service. A measure of profit was thus obtained and declared reasonable or unreasonable. The Commission in its February proposal has turned the entire scheme on its head and proposes to measure the reasonableness of rail rates on an existing carrier against the "cost" to construct a new carrier. Evidence has already been submitted in one case involving Potomac Electric Power Company,[1] in which Chessie System, defending against a $13.00 per ton rate alleged to be highly remunerative and unreasonable, has suggested that the rate under the "stand-alone cost" theory would not be unreasonable until it reached at least $182.00 per ton. The profit to the existing railroad, assuming a rate of $182.00 per ton, would be in the range of 1500 percent. Clearly, this departure from a cost-based standard measures "monopoly profit", not "economic profit" as previously understood. Moreover, the standard as it is now proposed has little, if any, relation to railroad efficiency. The Staggers Act Long-Cannon Amendment (49 U.S.C. 10707a(e)(2)(B)) requires that the Commission reconsider evidence of a railroad's pricing efficiency or inefficiency and the fairness of its treatment of captive traffic in determining the reasonableness of a given rail rate. Likewise, the revenue adequacy section of the Act (49 U.S.C. 10704(a)(2)) provides for standards for adequate rail revenues "under honest, economical, and efficient management."

Although the Commission's proposal acknowledges the direction of Long-Cannon, both the proposal and recent Commission decisions in related areas tend to downplay this essential ingredient of rate reasonableness—carrier efficiency and fairness. The Commission, although it committed several years ago in Ex Parte No. 338,[2] to so, has never systematically gathered data on railroad efficiency. When requested by several participants in this proceeding to institute a rulemaking proceeding to establish standards for consideration of these data or to set about gathering them, the Commission denied the rulemaking petition and suggested that, since it did not have adequate resources the *shippers* should undertake the task. Furthermore, the Commission shifted the burden of proof to the shippers affirmatively to demonstrate railroad inefficiency. In more recent decisions, it has denied discovery, narrowed the areas of permissible discovery, and recently stated that even proof of an inefficiency will not be sufficient if its correction does not make the carrier revenue adequate all by itself.

Removing efficiency as a test of rate reasonable creates the conditions for poor management, for so long as a railroad or any other business can make up its losses on one sector from monopoly profits in another, there will be no incentive to compete effectively in the competitive areas. Thus, the railroads will only have incentives to become increasingly less efficient, to the detriment of that industry and of the nation.

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[1] *Potomac Electric Power Company* v. *Baltimore & Ohio Railroad, et al.*, Docket No. 37872S.

[2] Standards and Procedures for the Establishment of Adequate Railroad Revenue Levels.

The Commission responds with the argument that so long as the railroads are revenue inadequate their incentives continue to be to aim toward profitability. However, the coal-hauling railroads are, in general, already highly profitable according to most measures. Thus, the coal-hauling railroads at issue in this proceeding are perfectly free to use unreasonable profits obtained from captive traffic to subsidize loses elsewhere occasioned by inefficiency or by pure predatory pricing, of for example, truck competitive traffic.

That this is occurring is evident from the testimony of John M. Anderson, A. T. Kearney Associates, Inc. With respect to pricing efficiencies, he points out that Burlington Northern traffic other than its coal traffic is only returning barely above its variable costs, 117 percent of variable costs. Its coal traffic, on the other hand, is returning 179 percent on average. He also demonstrates that Burlington Northern traffic other than coal consists of 225.854 million below variable cost—that is, losing money out of pocket. Put another way, 25 percent of BN's traffic is coal, but that traffic represents 40 percent of BN's profits. This latter figure demonstrates the particularly inequitable treatment of coal traffic, which has the distinction of contributing a very large share or net revenues to the railroad. Yet, the Commission proposes, apparently, to consider these rates reasonable per se and to permit them to quadruple over the next ten years.

The Interstate Commerce Act, as amended by the Staggers Rail Act of 1980, requires the Commission to balance the needs of carriers, shippes, and the public. Rather than, like the figure of Justice, holding that balance, the Commission has placed its own considerable weight on the side of the railroads It has declared in this rulemaking proposal that the railroads are entitled to charge whatever the market will bear (in 15 percent increments per year above inflation) on its captive coal traffic, without regard as to whether it deserves it or needs it. It is assumed that such increases in utility transportation costs will automatically be passed on to the consumer, which in the end will bear the burden of these unreasonable costs.

This Commission is charged with protecting shippers and consumers as well as with assisting the railroads to become efficient, and profitable to the extent they deserve it. The Commission might do much better for carriers by providing them with assistance and education for improving their record on their competitive traffic rather than focusing all their attention on the captive side of the equation. This should begin with a true Long-Cannon examination of their performance and with a realistic look at their rate base. Only then should electric ratepayers be tapped.

STATEMENT OF THE RAIL SHIPPERS COALITION

The Staggers Rail Act of 1980 was intended by Congress to reform railroad regulation allowing railroads greater flexibility in setting prices and reducing costs where transportation competition exists while continuing vital protection for captive shippers against abuses in rates and services arising from the exercise of monopoly power by the railroads. The Act also sought to promote rail-to-rail competition.

Clearly, the Interstate Commerce Commission, in implementing the The Staggers Rail Act, has ignored the intent of Congress and failed to provide meaningful balanced protection for captive shippers against monopolistic abuses by railroads. For example, the Commission has exempted whole commodity groups from the Act even though many shippers within these groups are captive to one rail carrier. Furthermore, the Commission has allowed several major rail carriers to cancel joint rates and through routes, as well as reciprocal switching agreements, causing the elimination of intradmodal rail competition—again in contravention of Congressional intent.

Legislation is necessary to assure that the Interstate Commerce Comission fulfills the balanced twin goals of the 1980 Act of elimination of unnecessary regulation and the continuance of necessary protection to captive shippers.

Among the critical subjects that must be addressed in such legislation are he following: Determination of reasonable rail rates for captive shippers; determination of railroad revenue adequacy; determination of railroad market dominance; prohibition against exemption of market dominant traffic; and prohibition against anticompetitive rail actions such as, cancellation of through routes, joint rates and reciprocal switching agreements.

The legislative amendments must reiterate and implement the legislative purposes that have been misinterpreted, ignored or cavalierly disregarded in the decisions of the Commission since the passage of the the Staggers Rail Act.

LIST OF ORGANIZATIONS SUPPORTING THE STATEMENT

National Association of Manufacturers.
Chemical Manufacturers Association.
National Coal Association.
Edison Electric Institute.
National Rural Electric Cooperative Association.
American Pubic Power Association.
American Bakers Association.
The Fertilizers Institute.
Western Fuels Association.
Mining and Reclamation Council.
Institute of Scrap Iron and Steel.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR KASSEBAUM AND THE ANSWERS THERETO

Question. Mr. Doyle, you've been critical of the ICC's measures of revenue adequacy. Their figures show that the railroads are earning a low rate of return. Don't electric utilities have a high rate of return by comparison—something on the order of 12-14 percent?

Answer. It is true that electric utilities generally earn a rate of return of 12 to 14 percent on their common equity, i.e., the amount invested by their stockholders in the form of common equity capital. This is not the same measure the ICC aplies in its determination of "revenue adequacy" of railroads. The ICC in its methodology utilizes return on "net investment" for purposes of determining revenue adequacy. The net investment utilized in the ICC calculation is a figure that is not comparable to that which would be utilized in the utility industry. The numerator of the Commission's formula into which the net investment base is divided to determine the rate of return on net investment is net railway operating income as reported by the railroads. This figure also differs substantially from the net income that is reported by utilities. This measure differs from the measure generally used to test the adequacy of electric utility earnings in the following respects:

(*a*) The ICC test applies the "current cost of capital" on 100% of the railroad's net investment including that portion of the investment which is funded by outstanding debt and preferred stock which have low fixed or embedded costs to the railroad. In determining electric utility rates of return only the lower embedded cost of debt and preferred is allowed on the portion of the net investment funded by the outstanding debt and preferred. This is significant. For example, if an electric utility with 60 percent of its total capital in debt and preferred at an embedded cost of 8 percent were allowed earnings based on a current cost of capital of 14 percent on 100 percent of its net investment as represented by its total capital, its actual rate of return on common equity would be 23 percent.

(*b*) Under the ICC methodology of "Retirement, Replacement, Betterment Accounting" railroads are permitted to expense replacement of track structure materials of equal quality in the period when replacement occurs. This expensing of the replacement of what is considered a capital investment by any other industry, including the electric utility industry, for investments in way and structures, results in an additive to annual operating expense in the year in which the investment is made. This charge to operating expenses results in a reduction in the reported annual operating income by an equal amount. The reduction in operating income produces a lower apparent rate of return on net investment. A study performed by GAO found that, generally, railroad earnings would be increased by 33⅓ percent if railroads were required by the ICC to apply normal depreciation accounting methodology by capitalizing and depreciating such replacements over their economic useful lives. The significance and impact of this item on the ICC's revenue adequacy measure can be illustrated by the fact that in 1982 the Burlington Northern Railroad (BN) charged $366 million of "Maintenance of Way" to its 1982 operating expense. The majority of this Maintenance of Way would have been capitalized under normal depreciation accounting. The result of this procedure is a reduction in operating income from approximately $612 million to $245 million—a 60 percent reduction in reported operating income. Electric utilities are required to capitalize and depreciate capital investments and are not authorized to expense these capital outlays in the year in which they occur. The procedures followed by electric utilities are those followed by all industries, other than railroads, and are in compliance with generally accepted accounting principles. The process of application of betterment accounting artificially reduces railroad net operating income and results in lower reported rates of return.

In February, 1983, at the behest of the DOT, the ICC changed the required method of railroad accounting for rate-making purpose to eliminate this feature of expensing capital outlays and now requires railroads to use capitalization and depreciation accounting for track structures in line with generally accepted accounting principles. However, in its January 26, 1983 decision in Docket No. 36988, *Alternative Methods of Accounting for Railroad Track Structures,* page 166, requiring such depreciation accounting, the ICC also authorized "inflation accounting" by railroads under which net investment would be restated and increased from its original cost to a current valuation. In the ICC own words "adoption of inflation accounting will in practice counterbalance" the effect of the change which eliminates the expensing of track replacements and requires their capitalization and depreciation.

The ICC's prior expensing of track related capital investment reduced the numerator in its ratio, which is used by the ICC to determine the apparent rate of return of the revenue adequacy test. Inflation accounting will increase the denominator of this same ratio. The concurrent effects of these two changes, therefore, will be a continuation of and a further understatement of the actual railroad rates of return.

(*c*) The ICC measure of net investment includes deferred tax reserves. In determining an electric utility's return on common equity, deferred tax reserves are not considered as capital funds supplied by the common stockholder and are not included in the denominator of the ratio to calculate the rate of return on common equity. It is not uncommon for deferred tax reserves of a railroad to equal ten to twenty percent of its total net investment in railroad property. For the year 1982, the total accumulated deferred tax reserves for Class I railroads amounted to $4.9 billion. For example, at the close of 1982 the BN had $508 million in deferred tax reserves and a net investment in railroad property of $4.5 billion out of a total net investment of $5.5 billion. Using the ICC's method of adding deferred taxes to net investment, the BN's "net investment" for the ICC's revenue adequacy test was inflated to 110 percent of its actual total in calculating its 1982 rate of return. This increase in the denominator of the equation again decreases the apparent railroad rates of return. The impact of the understatement of the ICC methodology for determining railroad "revenue adequacy" is substantial.

(*d*) In a recent GAO report entitled "Information On Regulatory Reform Under The Staggers Rail Act of 1980," dated August 17, 1983, the GAO in a discussion of railroad performance since the Staggers Act and the ICC's procedures for determining revenue adequacy indicated:

"However, financial analysts at Standard and Poor's and Moody's disagree with the implication that the industry is not financially healthy. Both firms' analysts stated that the industry was in relatively good financial condition. Standard and Poor's, for example, classifies company bonds as being either speculative or of investment-grade quality. Bonds rated as investment grade are found likely to provide timely payment of debt while there is a greater possiblity of default for speculative bonds. Of the 22 railroad bonds Standard and Poor's rated under this system, 18 were classified as investment-grade bonds. Two of the remaining four that were classified as being speculative just missed receiving an investment-grade rating." (at page 10)

In a discussion of the problems associated with the ICC's procedure for using a single criterion (return on investment) for determining revenue adequacy the GAO found:

"Financial analysts that we spoke with use a multi-criteria approach to evaluate a company's financial position. For example, Standard and Poor's, a major investment firm, uses cash flow, long-term debt-to-capital ratios, and pretax interest coverage, among other things in examining a corporation's financial health. It makes evaluations of the company's future credit strength (ability to pay debts) on the basis of current conditions and an assessment of the long-term outlook in which it considers management's financial projections. Another investment firm, Moody's also uses several similar criteria in evaluating a corporation's financial position." (at page 8)

From the comments made by GAO, as well as those of the financial houses, it becomes clear that the ICC's determination that no Class I railroad was revenue adequate for the year 1982 presents a substantially different picture of the railroad industry than is the actual fact. The Commission's procedures for determining revenue adequacy rely on an overstated investment base whose assets have never been analyzed or evaluated in order to determine whether these assets are used and useful (a procedure required of electric utilities) and an understated operating income figure due to the impact of Retirement, Replacement, Betterment Accounting.

These differences in the measure applied by the ICC to railroad revenue adequacy, as compared to the measure applied to electric utility revenue adequacy under generally accepted accounting principles, tend to compound each other and become significant. For example, although the American Association of Railroads (AAR) asserts that in 1982 the Burlington Northern earned "only 4.5% rate of return," the BN's 1982 Annual Report to Stockholders shows that it actually earned a rate of return on common equity of some 14 to 18% (dependent upon income tax treatment), significantly higher than most electric utilities earned in 1982.

Question. Mr. Doyle, earlier this year the ICC refused to investigate a rail rate increase to your facility at Iatan, Missouri. What was the magnitude of that increase and how much will it cost the electric rate payers of Kansas City Power & Light? Won't those costs be passed on to the ratepayers of KCP&L?

Answer. Yes, the ICC, even though admitting that the BN's proposed increased rail rate to Iatan might be 215% of its variable cost for the movement, said that it had approved rates with variable cost ratios higher than that, and thus permitted a 74¢ per ton increase on a movement of 2.4 million tons per year by the BN to KCPL's Iatan generating station. That $2 million per year increase theoretically will apply for the remaining 30-year life of that plant and our electric ratepayers will be required to pay that $60 million additional cost for coal transportation.

Question. Mr. Doyle, the railroads frequently claim that the coal shippers are not paying their fair share. Do you agree with this statement?

Answer. The American Association of Railroads (AAR) loudly asserts that coal shippers are not paying their fair share and seeks to underpin that assertion with statistics that are accurate—but misleading. The AAR compares tonnages and revenues for coal to other commodities and compares coal revenues per-ton and per-ton-mile to other commodities. Of course, these statistics will show that, as compared to other commodities, coal revenues are low because a unit train movement of coal is the most efficient and least-cost for any commodity tonnages transported by a railroad. In making these assertions, the AAR ignores the relative low costs of unit train movements of coal. The greater the distance for a unit train movement, the less the cost per-ton-mile for the railroad. As unit train movement distances became greater over the past decade, average rates being charged per-ton-mile for unit train coal movements, therfore, should have decreased. In reality, they have increased. In spite of that, the AAR complains that unit train rates per-ton-mile have increased only "a little" compared to other commodities.

The true test of whether coal shippers are paying their fair share is in the railroad margin of profitability on coal movements, i.e., the amount by which revenues exceed costs for the movement of coal as compared to other conmmodities transported by rail. In fact, the evidence shows that railroads are making excess profits on coal! On a per-ton basis, coal yields a 32.6 percent operating profit to the railroads while other traffic yields only 18.6 percent. In other words, coal's operating profit is 75 percent greater on a per-ton basis than the operating profit to railroads on other traffic. On a ton-mile basis, coal's operating profit is 77 percent greater than the operating profit on other traffic. No, I cannot agree with the AAR's assertion that coal shippers are not paying their fair share when, in fact, coal shippers are paying more than their fair share.

Question. Mr. Doyle, can't electric utility companies negotiate contracts with the railroads to protect consumers from railroad rate increases?

Answer. The answer is yes, electric utility companies and railroads have the legal capacity to negotiate contracts and enter into binding contracts, but as a practical matter electrical utilities cannot negotiate fair and reasonable contracts with railroad monopolies to protect our electric consumers from unreasonable rail rate increases. Where there is no reasonable coal transportation alternative available because the railroad is the only railroad serving in the mine area or the only railroad serving the electric generating station, then the railroad is in the monopolistic position and holds all the cards. For example, in current negotiations, where the Burlington Northern has no current competition for the transportation of coal from the Powder River Basin to KCPL's Iatan generating station, the BN is in a monopolistic position and is demanding (i) a 20-year "take-or-pay" contract, (ii) 100 Percent escalation based on the total rate, not just the variable portion of that rate, and (iii) that no future productivity increase be recognized in adjustment of the rate level. Agreeing to such provisions would hardly protect our electric consumers from unconscionable railroad rate increases in the future.

Senator **Danforth**. Thank you very much, Mr. Doyle.

Mr. Whelan.

Mr. **Whelan**. Thank you, Mr. Chairman and members of the subcommittee.

My name is Gerald Whelan. I am a lawyer in Hastings, Nebr. I represent the city of Hastings which owns its own electrical utility generation, transmission, and distribution system; so it is owned by the citizens of Hastings, which is a town of about 23,000.

That is one thing I am very proud of. The other thing is that I served with Gov. Jim Exon as his lieutenant governor for 4 years, and I did not share the joy of the rest of Nebraskans when we sent him to Washington.

There really is not much point in me reiterating the various technical points that have been made by Mr. Doyle very well and by members of this committee in interrogation of the ICC.

Let me tell you quickly about the Hastings story. I was interested in Commissioner Gradison's comments about product substitution. In 1973 and 1974 our natural gas pipeline company told us they were going to have a product substitution because natural gas was too valuable a product to put in the boiler, to use as a boiler fuel. So they said it is not only going to cost you three times too much, but it is just way too valuable to use as a boiler fuel, so we had to spend $70 million to build a new coal-fired generator.

Now, there are 23,000 people in that community. That is $3,000 we spent per man, woman, and child to build a powerplant. And in our preparations for that we found a mine, and we calculated the lowest possible Btu price laid into Hastings, and we negotiated a price of about $9 for coal. We also got a commitment out of the Burlington Northern at $13.25. So we thought that we could lay it in there and all of our consulting engineers thought we could really beat the price of natural gas. This was in April of 1980.

After we got our first shipments of coal, instead of $13.25, we were billed $16.03, $2.78 more, before we got one lump of coal on the site. And that was because the ex parte increases were added before we understood how they played the game, because we are really babes in the woods. This is our first trip down the track.

So we fought it. We filed an action before the ICC, and in our first hearing, based upon the administrative law judge's decision which took into consideration a variety of factors—cost of service, return of investment, some of these other things, Senator Long—he came up and said that the correct price should be $12.40. Well, we thought that was fine. But then he also had to tell us that there was a corresponding decision of the Commission which embarked upon this stand-alone theory. And I will tell you, we stood alone.

Because by that time our rate had gone to $17.95. And so by the stand-alone theory and by using all of these other things that these good folks from the railroads have been talking to you about, about all these rates going down—I looked at those charts. Well, this good administrative law judge said I am sorry; under this new regulatory atmosphere here that we have and under the interpretation of the Staggers Act and the obvious disregard of Long-Cannon and so forth, we cannot say that is illegal. So, therefore, we are going to dismiss your complaint.

Well, the smartest thing I ever did in my life was understand when I was beat, and I knew we were beat, and I knew that we did not have a chance with the philosophy of the ICC at that time. Here we took on the Burlington Northern, a little town, and beat them, we thought. But we went to that negotiation table so fast, because I knew we did not have any cards. We did not have one card because we did not have any place to go. And we negotiated a settlement as fast as we could, and now we are paying $16.31 for our coal.

Now, these figures over here were very interesting that they put up, but our coal still is costing us less than $10, and that was 2½ years ago, and our freight is costing us $16. You did not see that figure up there, did you? And when they talked about their equity and their return, last week in the Omaha World Herald, Senator Exon, there was a report that the railroad operating income of $164 million, that was for one quarter, was 33 percent above the second quarter of 1982.

Now, I do not know how they keep books. I do not know if they tell the reporters the truth and then they come up here, and I do not know where they get these figures. But I can tell you, like Mr. Doyle said, until this Commission understands that they have got to get rid of this bias about deregulation as far as captive customers are concerned, the people who are really captive customers cannot survive because the Burlington Northern is the only game in town, and Hastings Utilities—it is owned by the people of Hastings—is the only game in town for our electrical users.

Thank you.

[The statement follows:]

STATEMENT OF GERALD R. WHELAN ON BEHALF OF THE WESTERN COAL TRAFFIC LEAGUE, THE CONSUMER OWNED POWER COALITION, THE AMERICAN PUBLIC POWER ASSOCIATION, AND THE NATIONAL RURAL ELECTRIC COOPERATIVES ASSOCIATION

Good morning Mr. Chairman and members of the Subcommittee. My name is Gerald R. Whelan. I am appearing this morning on behalf of the Western Coal Traffic League, the Consumer Owned Power Coalition, The American Public Power Association, and the National Rural Electric Cooperatives Association. Each of these organizations, which are described in Exhibit A to this statement, is virtually concerned in matters affecting the rail transportation of coal and appreciates the opportunity to be heard this morning. Also appearing with me is C. Michael Loftus, an attorney specializing in rail transportation matters who has represented each of these organizations in various proceedings before the ICC and the federal courts.

I am a representative of the government of the city of Hastings, Nebraska. My testimony is offered from the perspective of one who has been involved in litigation under the Staggers Act and has directly experienced the problems which have arisen in connection with the new law's implementation by carriers, shippers, and most importantly, the Interstate Commerce Commission. Specifically, in my written statement today I will address five principal issue areas that affect all captive rail shippers and are central to the purpose of this hearing: (1) standards for determining revenue adequacy; (2) coal rate guidelines; (3) market dominance; (4) the railroad cost adjustment factor; and (5) the Railroad Cost Accounting Principles Board. After addressing these subjects in some detail, I will focus my attention on the litigation between Hastings Utilities and the Burlington Northern Railroad Company. I believe that this case exemplifies in some respects how the ICC's administration of the Staggers Act has gone awry.

Before turning to the specific subjects of my testimony, I would like to emphasize that insofar as the organizations I represent here are concerned, the ICC has totally mismanaged the statutory directives set forth in the Staggers Act, to the severe detriment of captive coal receivers. We believe that the Congress must take all necessary actions to stop the ICC's continued disregard for Congressional intent.

I. REVENUE ADEQUACY STANDARDS

A. Pre-Staggers Act standards

The concept of railroad "revenue adequacy" was introduced into commerce law through Section 205 of the Railroad Revitalization and Regulatory Reform Act of 1976 ("4-R Act"), Pub. L. No. 94-210, § 205, 90 Stat. 41. In Section 205 Congress added a provision to the Interstate Commerce Act currently codified at 49 U.S.C. § 10704(a)(2), which required the ICC to hold a rulemaking and promulgate, by February, 1978, standards and procedures for determining career revenue adequacy. This new section of the law established various financial criteria that the ICC should consider in determining whether a rail carrier was revenue adequate. The concept of revenue adequacy is important under the Staggers Act, as many of the rate freedoms granted in that statue depend upon a carrier's revenue adequacy status.

After conducting the Congressionally-mandated rulemaking proceeding, the ICC issued a comprehensive decision in 1978 promulgating standards and procedures for determining railroad revenue adequacy.[1] Those standards required the ICC to consider "all pertinent financial indicators" in determining whether a rail carrier was revenue adequate.

After promulgating its revenue adequacy standards, the ICC conducted a proceeding in which it applied them to determine which rail carriers were revenue adequate in 1978. In this decision, the ICC found, based upon its standards calling for an evaluation of all relevant financial data, that thirteen of the thirty-six Class I railroads then operating in the United States were revenue adequate.[2] The ICC's decision was intended to state the financial condition of the railroad industry as of 1978. Thereafter, the ICC looked at years 1979 and 1980; however, for those years, it simply calculated the railroads' cost of capital and did not, as it had for its 1978 determination, look to all relevant financial data to determine which carriers were or were not revenue adequate.[3]

The principal use by the Commission of its 1978 revenue adequacy findings was in individual rate complaint cases involving captive coal traffic at the ICC. In these cases, the ICC concluded that revenue inadequate carriers should be afforded higher coal rates.[4] Despite the fact that the ICC was using its revenue adequacy findings to justify high coal rates on captive traffic carried by "revenue inadequate" carriers, the nation's railroads were unsatisfied. Their position before the ICC was that the sole measure of carrier revenue adequacy should be whether an individual carrier was earning a current cost of capital return on its rate base. In addition, they argued that so long as a railroad was "revenue inadequate" it should be able to charge whatever it wanted on captive traffic. The ICC rejected both of these contentions.[5]

Having been rebuffed by the Commission, the railroads went to the Congress and asked that legislation be enacted which would effectively reverse the ICC's adverse rulings. Indeed, the railroads' claims concerning revenue adequacy formed the focal point of the Congressional deliberations which led to the October, 1980 enactment of the Staggers Rail Act. In the Staggers Act, the Congress rejected pleas made by the railroad industry to change its revenue adequacy provisions. Indeed, while the Staggers Act made substantial changes in other sections of the Interstate Commerce Act, it left the definition of railroad revenue adequacy unchanged, and made only one technical correction in Section 10704(a)(2) itself.[6]

While Congress did not alter the definition of carrier revenue adequacy, it did codify the ICC's administrative practice of considering the revenue adequacy status of a rail carrier in rate suspension investigations and reasonableness determinations, and utilized revenue adequacy as a means for determining when carriers should be entitled to certain new rate freedoms.[7] Finally, concered about the ICC's failure to make revenue adequacy determinations subsequent to 1978, Congress added Section 10704(a)(3) and Section 10704(a)(4) which required the ICC to complete a revenue adequacy proceeding within 180 days after the passage of the Staggers Act and thereafter to make annual determinations of carrier revenue adequacy.

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[1] Ex Parte No. 338, *Standards and Procedures for the Establishment of Adequate Revenue Levels,* 358 I.C.C. 844, modified, 359 I.C.C. 270 (1978).

[2] Ex Parte No. 353, *Adequacy of Railroad Revenue (1978 Determination),* 362 I.C.C. 198 (1979).

[3] *See,* Ex Parte No. 363, *Adequacy of Railroad Revenue (1979 Determination),* 362 I.C.C. 344 (1979); Ex Parte No. 381, *Adequacy of Railroad Revenue (1980 Determination),* 364 I.C.C. 311 (1980).

[4] See, e.g., *Cleveland-Cliffs Iron Co.* v. *ICC,* 664 F. 2d 568, 587 (6th Cir. 1981); *Burlington Northern Inc.* v *United States,* 661 F. 2d 964, 973–74 (D.C. Cir. 1981); *Celanese Chemical Co., Inc.* v. *United States,* 632 F. 2d 568, 576 (5th Cir. 1981), cert. dismissed, U.S. , 102 S.Ct. 27 (1981); *System Fuels, Inc.* v. *United States,* 642 F. 2d 112, 116 (5th Cir. 1981); *San Anotnio, Texas* v. *United States,* 631 F.2d 831, 848–50 (D.C. Cir. 1980).

[5] See Ex Parte No. 338, supra; Ex Parte No. 353, supra.

[6] Section 205 of the 4-R Act specified that the ICC could "revise and maintain" its revenue adequacy standards and procedures. Id. The word "revise" was deleted from the text of Section 205 when the law was recodified as Section 10704(a)(2). In the Staggers Act, Congress reinserted language providing the standards. Id., Section 205(b)(1), 94 Stat. 1906.

Thus, in the Staggers Act the Congress rejected the railroad industry's efforts to alter the ICC's pre-Staggers Act administration of Section 10704(a)(2) and, consistent with the ICC's administrative practice, added sections to the Act which gave greater ratemaking freedom to revenue inadequate carriers. Under the ICC's principal revenue adequacy rulings, the Commission was required to look at "all financial indicators" in making a determination of whether a carrier was revenue adequate, and, expressly rejected ratemaking standards which would permit revenue inadequate carriers to charge whatever they wanted on captive coal traffic.

B. Post-Staggers Act standards

In response to the Staggers act directives that the ICC complete, within 180 days, a Section 10704(a)(2) revenue adequacy proceeding, the ICC instituted a proceeding it denominated Ex Parte No. 393, Standards For Railroad Revenue Adequacy ("Ex Parte No. 393").[8] After receiving public comments, the ICC issued a final order in Ex Parte No. 393 on March 26, 1981. Therein, in a five member decision including one concurring and one dissenting opinion, the ICC repealed its previous revenue adequacy standards and adopted the single standard rate base/rate of return standard that both it and the Congress had previously rejected. Thus, under the ICC's Ex Parte No. 393 ruling, a carrier is not revenue adequate unless it earns a rate of return on its net investment base equal to the current cost of capital for the railroad industry.[9] It should be emphasized that in promulgating this standard the Commission rejected the specific recommendations of its own staff. At the Commission's request its Section of Financial Analysis contacted a number of analysts in the investment and financial community (including Merrill Lynch, Morgan Guaranty Trust, Metropolitan Life, Kidder Peabody, L. F. Rothschild, First Boston Corp., Salomon Brothers, Alexander Brown & Sons, Moodys, and Falmstock & Company) concerning their views on apropriate criteria for determining revenue adequacy for railroads. Only two mentioned rate of return on net investment base at all. They were unanimous, however, in their opinion that no single standard should be employed as the sole determinant of revenue adequacy.

Pursuant to this standard, no major railroad in the United States is revenue adequate, and there exists a truly massive gap between the railroads' existing earnings and those deemed necessary to achieve adequate revenues under the Commission's new standard. Moreover, the ICC added insult to injury in its Ex Parte No. 393 decision by making three individual findings concerning the composition of the rate base and rate of return standard which are wholly erroneous. First, the ICC ruled that deferred taxes are monies that ratepayers have contributed to the railroads and, as consistently ruled by appellate tribunals, deferred taxes should be excluded from carrier rate bases where a rate base/rate of return ratemaking standard is used.[10] Second, the ICC ruled that unused and nonuseful assets need not be excluded from carriers' net investment bases. The carriers themselves identified in Ex Parte No. 393 nearly a quarter billion dollars of unused and nonuseful assets in their rate bases, and a full scale investigation would no doubt reveal a substantial amount of additional assets that are either unused or nonuseful. Thus, under the ICC's decision, shoppers have to pay the carriers a return on property that is not used in providing transportation services. Again, such a practice is contrary to long-standing judicial precedent.[11] Third, the ICC ruled that all carrier debt costs should be calculated as though all carrier debt were paying current interest rates, even though a substantial portion of carrier debt was issued pursuant to debt contacts calling for fixed interest charges for less than current interest rates. The net effect of these three errors is to overstate, by substantial amounts, the sums of money carriers need to be revenue adequate under the rate base/rate of return standard.

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[7] See Staggers Act § 201(a), adding 49 U.S.C. § 10701a(b)(3) (ICC to consider its Section 10704(a)(2) revenue adequacy findings "[i]n determining whether a rate estabished by a rail carrier is reasonable. . . ."); Staggers Act § 203(a), adding 49 U.S.C. § 10707a(d) (revenue inadequate rail carries permitted to take designated rate increases which cannot be suspended by the ICC) and adding 49 U.S.C. § 10707a(e) (ICC to consider Section 10704(a)(2) findings in specified complaint and investigation proceedings); Staggers Act § 217, adding 49 U.S.C. § 10705a (revenue inadequate rail carriers permitted to take specified rate surcharges not available to revenue adequate carriers).

[8] See 45 Fed. Reg. 80150, Dec. 3, 1980.

[9] Ex Parte No. 393, Standards for Railroad Revenue Adequacy, 364 I.C.C. 803 (1981).

[10] See, *San Antonio, Texas* v. *United States,* 631 F. 2d 831, 847 (D.C. Cir. 1980); *Iowa Public Service Company* v. *ICC,* 643 F. 2d 542, 546–547 (8th Cir. 1981); *Cleveland-Cliffs Iron Co.* v. *ICC,* 664 F. 2d 568, 586 (6th Cir. 1980).

[11] See, e.g., *Denver Union Stockyard Company* v. *United States,* 304 U.S. 470, 475 (1938); *Tennessee Gas Pipeline Company* v. *FERC,* 606 F. 2d 1094, 1109 (D.C. Cir. 1979), cert. denied, 445 U.S. 920 and 447 U.S. 922 (1980).

In addition to adopting the rate base/rate of return standard expressly rejected by the Congress in the Staggers Act as the sole measure of carrier revenue adequacy, the ICC also began to depart from its pre-Staggers Act position that revenue inadequate carriers could not charge "what the traffic will bear" rates on captive coal traffic. In all of its post-1982 decisions involving coal rates (each of which has involved ICC review under Section 11501(c) of the Act of state orders involving intrastate coal transportation) the ICC has permitted involved carriers to charge whatever they would like on captive coal traffic on grounds that such rates are necessary to promote their revenue adequacy.[12] Thus, the ICC appears to have abandoned its previous administrative position that revenue adequacy was only one factor to be considered in determining the reasonableness of individual rates. Placing sole reliance on the carriers' "revenue needs" is in direct contravention of the intent of Congress expressed in the Staggers Act. Congress called upon the ICC "to provide a regulatory process that balanced the needs of carriers, shippers and the public" in setting maximum coal rates and, given the fact that all rail carriers are revenue inadequate under the current rate base/rate of return standard, effectively deregulates maximum coal rates on captive traffic. This is not what Congress had in mind when it enacted the Staggers Act.[13]

C. The railroad industry exudes financial health

As demonstrated, the ICC has wrongfully reversed its pre-Staggers Act revenue adequacy positions. Moreover, it is important to point out that the ICC's general conclusion that no major rail carriers are revenue adequate is contrary to a tremendous body of financial data, which has been widely reported in the financial press. This material demonstrates that the rail industry is, in fact, exuding financial health and wealth. Witness the following items:

Burlington Northern, characterized just last year by a prominent business publication as a "cash cow" (Business Week, March 8, 1982), the accuracy of that lable by amassing a 1.5 billion dollar war chest, a portion of which it used to gobble up El Paso Company earlier this year (BN Tender Offer, December 21, 1982, p. 38);

CSX, another family of supposedly revenue-inadequate carriers, has somehow scraped together over a billion dollars, with which it is currently trying to buy Texas Gas Resources Company (see Wall Street Journal, July 1, 1983);

In April 1982, even before their merger, Southern and the N&W were reported to have amassed war chests for corporate acquisitions totaling more than three quarters of a billion dollars (Forbes, April 12, 1982);

Between January 1979 and April 1983, the price of Burlington Northern's stock more than tripled, from $20-$25 per share to more than $80 (Trendline's Current Market Perspectives, April 1893, p. 44), reflecting investors' confidence in BN's future prospects (and, incidently, confirming the ready availability of external financing, should BN ever want to use it). During this same period, Standard & Poor's composite index of railroad stock prices also shot up dramatically, more than doubling (up 134 percent). In sharp contrast, the S&P composite index of 500 companies went up only 65 percent during that same period, and the S&P electric utility index went up only 13 percent.

The "Value Line Investment Survey," a widely-respected service, predicted recently that "Cyclical recovery of rail traffic, coupled with the heavy operating leverage inherent in railroading, should support big profit gains through 1985-86" for the nation's railroads (Value Line, April 8, 1983, p. 304):

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[12] See, e.g., No. 38793, *Petition For Review of A Decision of the Public Service Commission of West Virginia Pursuant to 49 U.S.C. 11501*, (Decision served March 18, 1982), appeal docketed sub nom. *Wheeling-Pittsburgh Steel Corp.* v. *United States*, No. 82-3122 (3rd Cir. March 25, 1982); No. 39060, *Petition of the Denver and Rio Grande Western Railroad Company and Salt Lake, Garfield and Western Railway Company for Review of A Decision of the Public Service Commission of Utah Pursuant To 49 U.S.C. 11501* (Decision served March 2, 1983), appeal docketed sub nom. *Utah Power & Light Co. v. ICC*, No. 83-1276 (D.C. Cir. March 15, 1983); No. 38946, *Petition of the Louisville and Nashville Railroad Company For Review of A Decision of the Public Service Commission of Indiana Pursuant to 49 U.S.C. 11501* (Decision served June 23, 1983), appeal docketed sub nom. *Public Service Commission of Indiana, Inc.* v. *ICC*, No. 83-1691 (D.C. Cir., June 24, 1983).

[13] These cases were not decided under the most recent proposals issued by the ICC in Ex Parte No. 347 (Sub. No. 1), Coal Rate Guidelines, Nationwide. These new proposals are discussed infra.

Value Line has included Burlington Northern on its "Timeliness" [recommended] list, reporting: "It's easy to see a bright future for BN in railroading and energy. Coal and grain traffic are likely to be more profitable than ever as a result of improved operating efficiency. . . . There may be more acquisitions—possibly of railroads, if the price is right (i.e., if the stock prices of attractive targets such as Santa Fe or Southern Pacific decline or if, we guess, BN's stock prices rise high enough)" (Value Line, May 20, 1983, p. 1232).

Standard & Poor's industry surveys reported in October 1982 that "with some $800 million in cash an temporary investments at June 30, the Norfolk Southern enjoys excellent financial health and is in a position to undertake a major diversification effort while maintaining generous dividend payments.

In short, the coal hauling railroads are certainly not financial basket cases, needing special dispensation to continue gouging electric utilities and their rate payers in order to avoid complete collapse.

The ICC has shown no intention of reassessing its position on revenue adequacy. Only the Congress, by reiterating its prior mandate, can return the ICC to a posture of looking to all relevant financial indicators in assessing carrier revenue adequacy. Section 8 of S. 1082 achieves this purpose, and would operate to correct the errors committed by the ICC in Ex Parte No. 393.

II. COAL RATE GUIDELINES

One of the most critical issues that must be addressed by this Committee and the entire Congress concerns the ICC's policy regarding maximum reasonable rates on captive coal traffic—traffic which enjoys no alternative to rail service when it comes to transportation. The developments in this area over the past several years have been complex and ofter contradictory, but one point is crystal clear: under the ICC's present "formula" coal shippers and receivers—as a practical matter—are left utterly without protection from the unrestrained pricing practices of the handful of railroads which totally dominate the volume coal transportation market.

A. The situation prior to the Staggers Act

Ever since the onset of ICC authority to prescribe railroad rates, the statutory standard governing such prescriptions has remained the same: any rate over which the ICC has jurisdiction must be "reasonable.[14]

Traditionally, and under the 4-R Act, the ICC relied principally upon three criteria in evaluating the reasonableness of rates under its jurisdiction: comparisons of a challenged rate with established rates for comparable movements; the relationship between the rate and the cost of providing service; and the requirements of the public interest. Over the years leading up to enactment of the Staggers Act, the Commission's reliance on one of these criteria, the relationship of a rate to the cost of service, gradually increased to the point that in a series of decisions served in 1979 it was basing its maximum rate determinations almost exclusively on costs. Beginning with its decisions in Annual Volume Rates On Coal—Wyoming to Flint Creek, Arkansas [15] and *San Antonio, Texas* v. *Burlington Northern, Inc.*,[16] the ICC settled upon a cost of service-based formula for determining maximum coal rate levels which became known as the "seven percent solution." Under this formula, the rate was set at a level designed to provide the defendant carrier with revenues sufficient to cover:

(1) The variable costs of service as determined under established ICC costing procedures;

(2) A proportionate share of the carriers' fixed or constant costs;

(3) A return on the carriers' investment equal to the current cost of capital, including an additive for incremental fixed plant investment. and

(4) A seven percent additive or cross-subsidy, awarded on the basis of promoting railroad revenue adequacy.

The first three components of this formula, when combined, constituted what was described as fully-allocated costs at the revenue need level. No one has ever really disputed (except in certain pre-Staggers Act contract cases) that the railroads should be permitted to earn rates on coal traffic equal to fully-allocatd costs at the revenue need level, so long as such costs were properly determined. The problem arose in the Commission's consistent habit of making critical errors, which had the effect of significantly overstating such costs.[17]

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[14] This standard continues to govern today. 49 U.S.C. § 10101a(b).

[15] Docket Nos. 36970 and 36980 (Decisions served May 21, 1979).

[16] 361 I.C.C. 482 (1979).

Coal shippers consistently objected to being forced to pay rates higher than the fully-allocated costs level, which, in effect required them to cross-subsidize shippers of other commodities which were not paying rates high enough to afford the carriers a full return on that traffic. The railroads, on the other hand, argued that if they must earn a given rate of return on all of their traffic, on average, in order to be financially healthy, if they earn less on some traffic due to competitive forces which hold prices down, they must be permitted to charge more on captive traffic in order to average out to the required return level. Under this theory, known colloquially as "differential pricing," the railroads have consistently contended that they must be allowed rates on individual movements which are far in excess of fully allocated costs at the revenue need level.

The fourth element of the ICC's seven percent solution, the seven percent cross-subsidy or differential pricing additive, represented its resolution—at the time—of the question how much, if anything, the railroads should be permitted above the full cost level. Thus, the ICC explained:

"The railroads must be able to price some of their services above full cost if they are to compensate for the fact that competition forces them to price certain services above variable costs but below full costs . . . .

"Nevertheless, the railroads should not be allowed to make up their entire shortfall while extracting monopoly profits from captive shippers. It is essential that some limit be placed on rates to prevent unfairness to individual shippers and distortion in the economy . . . . (emphasis added)

"The question is one of determining the extent to which some shippers should subsidize others in the interest of producing a financially viably rail system.[18]

The ICC felt that it was reasonable to impose an additive of seven percent above full costs based upon the fact that the carrier's overall revenues were inadequate. Although it left open the possibility that the railroads could obtain differential pricing additive higher than seven percent, the ICC stated that before it would consider any greater additive the railroads would be required to submit specific evidence demonstrating their entitlement.[19]

At the time it adopted the seven percent solution, the ICC explained that it was only relying on it as an "interim approach," pending a decision in its Ex Parte No. 347, *Western Coal Investigation* proceeding. Ex Parte No. 347 had been initiated in May, 1978 as a broad-scope investigation to consider and establish principles for general application in determining reasonable rate levels for western unit train coal traffic.[20]

From May 1979 until June 1980, the ICC decided seven coal rate cases under the seven percent solution, each time noting that the formula was an interim approach pending the outcome of Ex Parte No. 347.[21] On June 9, 1980, the U.S. Court of Appeals for the D.C. Circuit issued a decision in *San Antonio, Texas* v. *United States.*[22] Ruling favorably upon an appeal by San Antonio from the ICC's decision in *San Antonio, Texas* v. *Burlington Northern, Inc.*, the appellate court found that the ICC's decision was "arbitrary and capricious in that it provides no defensible rationale for the inclusion of the seven percent increment." [23] The court did not rule that it would be improper to approve any increment above full costs, but stated that the ICC "must provide adequate justification for its choice of a particular increment above fully allocated costs." [24] Finding that the ICC had committed a number of errors in its development of cost findings as well, the court vacated the decision and remanded the case for further consideration.

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[17] See *Houston Lighting & Power company* v. *United States*, 606 F.2d 1131, 1148 (D.C. Cir. 1979), cert. denied, 444 U.S. 1073 (1980); see also, *San Antonio, Texas* v. *United States*, 631 F.2d 831, 850, 852 (D,C, Cir. 1980).

[18] *San Antonio, Texas* v. *Burlington Northern, Inc.* 361 I.C.C. at 495.

[19] *Id.*, at 496.

[20] 43 Fed. Reg. 22151 (May 23, 1978).

[21] See Annual Volume Rate on Coal—Wyoming to Flint Creek, Arkansas, 361 I.C.C. 533 (1979), remanded, *Burlington Northern Corp* v. *ICC*, No. 79-1547 and No. 70-2067 (D.C. Cir. 1980); *Arkansas Power & Light Co.* v. *Burlington Northern Corp.*, 361 I.C.C. 504 (1979), remanded, *Systems Fuels Inc.* v. *United States*, No. 79-2491 (5th Cir. April 8, 1981); *Bituminous Coal, Hiawatha, Utah to Moapa, Nevada*, 361 I.C.C. 923 (1979), remanded, *Union Pac. R.R. Co.* v. *United States*, 637 F. 2d 764 (10th Cir. 1981); Docket No. 37105, *Increased Rates on Coal—Colstrip and Kuehn, Montana to Minnesota*, decision served Oct. 26, 1979; *San Antonio, Texas* v. *Burlington Northern Corp.*, 361 I.C.C. 482 (1979), remanded, *San Antonio, Texas* v. *United States*, 631 F. 2d 831 (D.C. Cir. 1980); Docket No. 37029, *Iowa Pub. Serv. Co.* v. *Burlington Northern Corp.*, decision served July 13, 1979, remanded *Iowa Pub. Serv. Co.* v. *ICC*, 643 F. 2d 542 (8th Cir. 1981); Docket No. 37021, *Annual Volume Rates on Coal—Rawhide Junction, Wyoming to Sergeant Bluff, Iowa*, decision served July 13, 1979, remanded, *Iowa Pub. Serv. Co.* v. *ICC*, 643 F. 2d 542 (8th Cir. 1981).

[22] 631 F. 2d 831 (D.C. Cir. 1980).

[23] Id., at 851.

This was the status of the law concerning the standards for determining maximum reasonable coal rates at the time the Staggers Act was enacted. The ICC's seven percent solution "interim" approach, which it had held to for a year, had been set aside and no decision had been issued in Ex Parte No. 347, which was to be the proceeding in which a "permanent" approach was to be adopted.

B. The Staggers Act

The general rule contained in 49 U.S.C. 10101a(b) (added by the Staggers Act), that rail rates on market dominant traffic must be "reasonable," is the same as that which existed prior to the Staggers Act. This is not to say, however, that Congress was unconcerned in 1980 with the fate of captive shippers—particularly coal shippers. As a matter of fact, concern over the impact of railroad pricing practices on captive coal receivers played a major part in the development of the Staggers Act, and no other commodity was so singled out for special Congressional attention.

The legislative history of the Staggers Act is replete with evidence of Congress' concern that effective constraints be placed upon captive coal rates:

"This bill provides continued protection for shippers where such protection is necessary in the public interest. The [Senate] Committee [on Commerce, Science and Transportation] expects this protection to be utilized by the Commission to prevent extensive cross-subsidization or an excessive contribution from captive traffic. The rates on coal are of particular concern in view of the many substantial increases imposed on this traffic in the last several years. While recognizing that not all traffic can be transported at a fully allocated cost level due to competitive considerations, it is the Committee's intent that the Commission play an active role in insuring that such traffic bears its fair share of costs and that higher rated captive traffic is not duly burdened. [25]

Not only did Congress express an intent that captive coal traffic not be exploited by the nation's rail carriers, but it pointed to express directives in the law that this not occur:

"The new section [49 U.S.C. § 10101a] establishes a specific rail transportation policy to guide the Commission in its duties in regulation of the railroad industry. The Conferees intend that this policy include the encouragement and promotion of the transportation of coal by rail in accordance with the objective of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition." [26]

To the same effect, the Senate Commerce Committee Report admonished that:

"The Committee emphasizes that the railroads must improve their efficiency and cannot expect to achieve revenue adequacy by simply increasing rates which are already at a high level in relation to costs. The Commission is directed to continue to provide protection in such situations." [27]

In addition to the numerous statements contained in the legislative history of the Staggers Act, a particular set of statutory provisions were written into the law itself in an effort to safeguard against rail cross-subsidization and supra-competitive pricing at the expense of coal shippers and receivers. Known as the "Long-Cannon Amendments," these provisions included the following directive:

"(C) in determining whether a rate is reasonable, the Commission shall consider, among other factors, evidence of the following: (i) the amount of traffic which is transported at revenues which do not contribute to going concern value and efforts made to minimize such traffic; (ii) the amount of traffic which contributes only marginal to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and (iii) the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues." [28]

The objective of the sponsors was to provide protection for captive rail shippers as a balance against the flexibility granted to the railroads in pricing their competitive traffic and in imposing rate increases upon their market dominance traffic. As Senator Cannon stated in describing the Long-Cannon Amendment on April 1, 1980:

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[24] Id., at 852.

[25] S. Rep. No. 96–470, 96th Cong. 1st Sess. 7 (1979).

[26] H.R. Rep. No. 96–1430, 96th Cong. 2d Sess. 80 (1980).

[27] S. Rep. No. 96–470, supra, at 8.

[28] See 49 U.S.C. § 10707a(e)(2)(C).

"The bill we are considering, S. 1946, continues maximum rate protection for captive shippers. The bill itself was designed to provide additional flexibility for carriers while maintaining appropriate protection where competition is not adequate." [29]

Senator Long placed the same emphasis upon ensuring that captive shippers not be compelled to subsidize the railroads' competitive traffic to an unreasonable degree:

"The issue is whether this profit in subsidy should be completely without limits and at the sole discretion of the railroads." [30]

While a strict equality in the contributions made by different traffic segments to the railroads' fixed costs was not required (nor, really, possible), it was clearly the intent of the framers of the Long-Cannon Amendment that captive traffic could not be compelled to bear the overwhelming burden of those costs in order to subsidize arbitrarily underpriced traffic.

The statutory criteria set forth in the Long-Cannon Amendment are very similar to those which were established by the ICC in the "seven percent solution cases," which the railroads had to address before the Commission would permit any cross-subsidy greater than the seven percent additive. They are designed to afford protection to captive shippers, such as coal shippers, in order to ensure: (a) that cross-subsidies imposed on captive traffic are justified, (e.g., that the revenue shortfalls which they cover are not due to poor management); and (b) that the burden of the revenue shortfall which captive traffic may legitimately be required to bear is fairly distributed among captive shippers and not unfairly heaped upon one commodity, such as coal.

Thus, not only did Congress not change the general, pre-Staggers Act requirement that rail rates on market dominant traffic be held to "reasonable" levels; the legislators specifically added additional factors to be taken into consideration by the ICC in evaluating rates shown to be within its jurisdiction. Unfortunately, in the words of Congressman Nick Rahall of West Virginia, the ICC has administered the provisions of the Staggers Act designed to protect captive shippers in a "roguish and irresponsible manner."

C. ICC ratemaking efforts under the Staggers Act

Shortly after enactment of the Staggers Act, the ICC proposed new guidelines for establishing maximum reasonable rate levels for coal transportation in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines—Nationwide. As with the seven percent solution, the guidelines proposed in Ex Parte No. 347 (Sub-No. 1) embodied the formula approach for determining maximum reasonable coal rate levels. The elements of the proposed formula included: (1) The variable cost of service; (2) A share of the railroad's fixed costs determined on the ton/ton-mile method of allocation; and (3) A return on the carrier's investment equal to the current cost of capital.

Although the guidelines set forth by the ICC in its Notice in Ex Parte No. 347 (Sub-No. 1) were only "proposed," they were applied in all coal rate cases decided between November 1980, when the Notice was issued, and December 1981, when the ICC issued an interim decision rejecting the guidelines. (Characteristically, following the December 1981 interim decision the ICC began undoing all that had been wrought under the prior guidelines.) [31]

In the comments filed in response to the ICC's proposal in Ex Parte No. 347 (Sub-No. 1), the railroad parties continued to advocate the use of "Ramsey Pricing" as the standard for evaluating maximum rate reasonableness. Reduced to simple terms, Ramsey Pricing holds that the more captive a given segment of traffic is, the higher a rate it should pay. The mechanical means through which this theory is carried out involve what are known as "coefficients of elasticity," which purport to measure the demand elasticities of each of the several commodities handled by the railroads.

In practical effect, the railroads proposed—and have consistently argued—that the ICC should permit them to price their traffic in any way they see fit until such time as they have achieved "revenue adequacy." Indeed, the railroads' witnesses in Ex Parte No. 347 (Sub-No. 1) testified that "where firms are not earning their cost of capital . . . there is no economically sound rationale for regulating rates." [32]

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[29] 126 Congressional, Record. S. 3828 (daily ed., Apr. 1, 1980) (remarks of Senator Cannon).

[30] 125 Congressional Record S. 18775 (daily ed., Dec. 17, 1979) (remarks of Senator Long).

[31] See, e.g., No. 81-1547, *Burlington Northern Inc.* v. *U.S.*, (D.C. Cir.), Order served Mar. 11, 1982.

[32] V.S. of railroad witnesses Moses and Braeutigan, at page 20.

On December 21, 1981, the ICC served a decision in which it rejected the ratemaking guidelines it had proposed in Ex Part No. 347 (Sub-No. 1), and requested further comments as to the type of standard that should be adopted. The ICC gave two basic reasons for abandoning its ton/ton-mile approach. First, the ICC stated that it failed to take into consideration sufficiently a carrier's revenue needs in establishing rates. Thus, for example, a carrier with adequate revenues could obtain the same rate level under the proposal as a carrier with inadequate revenues. The ICC appeared to be particularly concerned with allegations by five eastern railroads that under its ton/ton-mile methodology revenue could actually be significantly decreased. Second, the ICC felt that the proposed methodology did not generate rates "which sufficiently reflected demand factors," because the rates were based solely on costs. Although the ICC made clear in its decision that it continued to believe that demand factors should be considered in establishing maximum rates, however, it indicated it was not prepared to accept the railroads' "Ramsey Pricing" proposal, which is based totally on demand, because it found that such pricing "would give the (railroads) virtually unconstrained pricing freedom on captive traffic." [33]

Between December 21, 1981 and February, 1983, ICC decisionmaking on the issue of maximum reasonable rates on coal traffic ground to a halt. The ICC had rejected its previously proposed methodology, but had suggested nothing but a "case by case" approach to replace it. As a result, a number of pending maximum coal rate cases, many of which were several years old and were on remand from the courts of appeals, continued to languish.[34]

D. Ex Parte No. 347 (Sub-No. 1)—February 1983

On February 24, 1983, the ICC served a decision in Ex Parte No. 347 (Sub-No. 1), proposing an entirely new methodology for evaluating captive coal rates. Abandoning altogether a cost-based approach, the ICC's new formula begins with the premise that a "revenue inadequate" carrier can charge any rate it chooses on a given captive coal movement. The carrier's pricing freedom can only be restrained—under the ICC's decision—if one of four "constraints" are violated: (a) a rate may not exceed the so-called "stand alone costs" of the movement; (b) a rate should not impose on a shipper unavoidable costs attributable to obvious management inefficiencies; (c) a rate should not be increased by more than 15 percent per year after inflation; and (d) once a carrier achieves revenue adequacy as defined by the ICC, other factors will be considered in determining rate reasonableness.

There is no question that the ICC's new methodology—which it has already stated will be applied in pending cases notwithstanding its "proposed" status [35]—may prove to be an unmitigated disaster for the cause of balanced rail rate regulation, and the maintenance of equity and protection for captive coal shippers. While no cases have yet been decided under the new "formula," there are very real indications that it will not operate to provide any meaningful relief from monopolistic, supra-competitive rail rates on coal, particularly if several unresolved issues upon which the ICC is seeking further comment are not decided correctly.

The "stand-alone" constraint caps rates at a level equal to the cost which a carrier would have if the only shipper it served on a given line were the shipper seeking to litigate the rate in question. It is not inaccurate to say that in many respects this amounts to "capping" a rate at a level equal to a shipper's cost of acquiring and operating its own rail line. While one cannot presently be sure of the level at which rates set under such a "constraint" would hover, the testimony of one carrier in a pending ICC rate case indicates that in the railroad's view the stand-alone cap imposes no real restraint at all. According to "conservative" evidence submitted by the Baltimore & Ohio Railroad in Docket No. 37872, *Potomac Electric Power Co.* v. *Bal-*

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[33] Ex Parte No. 347 (Sub-No. 1), Interim Decision served December 21, 1981, at 4.

[34] E.g., Docket No. 36180, *San Antonio, Texas Acting By and Through Its City Public Service Board* v. *Burlington Northern Railroad, et. al.*; Docket No. 36401 (Sub-No. 1), *Kansas City Power & Light Company* v. *Kansas City Southern Railway*; Docket No. 37226, *Incentive Rates on Coal—Axial Creek, CO to Coleto Creek, TX*; Docket No. 37450, *Central Illinois Light Companies* v. *The Atchison, Topeka & Santa Fe Railway Company, et. al*; Docket No. 37667, *Central Louisiana Electric Company* v. *Burlington Northern Railroad Company*; Docket No. 38738, *Omaha Public Power District* v. *Burlington Northern Railroad Company*; Docket No. 37021, *Annual Volume Rates on Coal—Rawhide Junction, Wyoming to Sergeant Bluff, Iowa*; Docket No. 37038, *Bituminous Coal from Hiawatha, Utah to Moapa, Nevade*; Docket No. 37063, *Incrased Rates on Coal, L&N RR, October 31, 1978*; Docket No. 37135, *Increased Rates on Coal, BN, Montana to Superior, WI*; No. 37276 (Sub-No. 1) *Coal, Wyoming to Redfield, Arkansas*; No. 37409, *Aggregate Volume Rate on Coal, Acco, Utah to Moapa, Nevada*; Docket No. 38738, *Western Farmers Electric Cooperative* v. *Burlington Northern Railroad Company*; Docket No. 38772, *Unit Train Rates on Coal, Thunder Junction, Wyoming to Mill, Texas.*

[35] Docket No. 36180, et al., supra, Order served June 2, 1983.

timore & Ohio Railroad Co. et al., for example, application of the ICC's "stand-alone" cap to the eastern utility coal movement there in issue would allow rates in excess of approximately $182.00 per ton, some 1,400 percent higher than the approximately $13 rate being challenged by the utility as beyond a maximum reasonable level.[36]

The ICC's second named "constraint" is likewise illusory. While the Commission has stated that shippers will not be forced to bear costs attributable to managerial inefficiency, it has enunciated no standard whatsoever for measuring efficiency, nor does it possess a proper data base. According to the Commission, this "constraint" is designed to incorporate the Long-Cannon Amendment into the ICC's ratemaking methodology. As will be discussed in more detail infra, however, the ICC has indicated no intent to require carriers to divulge the information necessary to any assessment of managerial efficiency—information which they alone possess. Through its second "constraint," the ICC has merely tossed a bone to shippers which is totally devoid of any meat.

The third "constraint" imposed under the new guidelines purports to "limit" rail carrier increases to 15 percent per year after inflation. Despite the fact that Congress itself set 6 percent as the upper limit of the zone of rate flexibility available to rail carriers without fear of ICC scrutiny under § 10707a (the zone drops to 4 percent—with eligibility limited to revenue inadequate carriers—in 1984), the Commission has taken it upon itself to almost triple that figure by administrative fiat—so long as a carrier does not increase a rate by more than 15 percent per year after inflation, the ICC has stated in its February 24, 1983 decision that it simply will not entertain complaints against the rate. Why did the ICC choose 15 percent (why not 7 percent or 20 percent)? Because according to the Commission, if all coal rates increase by 15 percent per year, the entire rail industry will achieve revenue adequacy (as defined by the ICC) by the time the ICC predicts coal slurry pipelines will become available (7 to 9 years) [37] to shippers. The implications of this rationale are astounding. In direct contravention of the stated, manifest will of Congress as plainly set forth in the Staggers Act, the ICC has told the nation's railroads that they may—and are indeed encouraged to—look to a single captive commodity for the recovery of their entire perceived revenue shortfall. We would submit this constitutes as plain a violation of the governing statute as can be defined.

Additionally, the ICC's 15 percent figure suffers from the same lack of rational evidentiary support as the "seven percent solution," condemned by the D.C. Circuit in 1980. The numbers have changed, but the game apparently has remained the same.

Finally, the Commission's fourth "constraint" is nothing more than a loose end. The ICC has given no indication of how its evaluation methodology would change once a carrier became revenue adequate, and has offered no real hope to the captive shipper community that even the attainment of this "goal" will slow the tide of rising coal transportation rates.

According to a study prepared for the Edison Electric Institute, under the ICC's new guidelines the price of transporting coal by railroad—which was approximately $5 billion in 1982—could quadruple in ten years to over $20 billion. If the carriers "limited" themselves to 15 percent annual increases—rather than attempting to approach the stand-alone ceiling—a rate which stood at $12.02/ton in 1982 could be expected to rise to $48.59/ton by 1992. The electric bill for U.S. Government operations in the Washington, D.C. area alone could increase by $3,000,000 in the first year; to be paid through taxes by many of the very same people who would also be paying utility rate increases caused by the same rail rate escalations.[38]

The ICC's new proposed coal rate guidelines are essentially useless tools in a captive shipper's effort to obtain relief from monopolistic rail rates. If these guidelines become final—and there is presently no indications that the ICC is contemplating anything to the contrary—it will truly be "open season" on captive coal traffic. Congress must not sit by and permit the curtain to fall on the coal rate guidelines story in the manner indicated by the present script. Otherwise, the burden of railroad revitalization will continue to be borne exclusively by the nation's captive coal receivers and, ultimately, by the millions of individual consumers they serve.

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[36] V.S. of R. W. Bond, Mar. 14, 1983, at p. 3.

It should also be pointed out here that the ICC's version of the "stand-alone" concept bears no resemblance to the stand alone costing approach recognized by the economic community as a valid ratemaking constraint. See, e.g., Comments of the Western Coal Traffic League and Consumer Owned Power Coalition in Ex Parte No. 347 (Sub-No. 1), Apr. 13, 1982.

[37] For most carriers, revenue inadequacy would be achieved in far less time. See Ex Parte No. 347 (Sub-No. 1), decision served Feb. 24, 1983. Appendix D.

[38] Source: Edison Electric Institute, Railroad Coal Rates: A Stand Against An Unregulated Monopoly, at pp. 5–6, table 3, figure 3 (1983).

E. ICC ignorance of the Long-Cannon criteria

As noted previously, Congress' concern for the protection of captive coal shippers led to the enactment of the Long-Cannon ratemaking criterial, presently codified at 49 U.S.C. § 10707a(e)(2)(C). Designed to balance the general ratemaking flexibility granted the nation's rail carriers elsewhere in the Staggers Act, the Long-Cannon criteria require that the Commission, in determining whether a rail rate is reasonable, consider several factors relating to the relative profitability of the different segments of traffic hauled by the carrier involved. The Commission must consider the amount of non-compensatory traffic hauled by the carrier, the extent to which the carrier maximizes its revenues from marginal traffic and the mix of the carriers' traffic and whether particular segments of traffic are being required to pay an unreasonable share of overall revenues. These criteria are similar to those identified by the Commission in coal rate cases decided prior to the Staggers Act,[39] and are obstensibly the principal means by which one can "root out" improper cross-subsidization and the imposition of a disproportionate share of the burden of railroad revitalization on a given segment of traffic or commodity (such as coal).

Consideration of these criteria is extremely important to captive shippers because it is these shippers that are asked to make up any revenue deficiencies or shortfalls which the railroads may experience in hauling competitive traffic. Only by considering such factors can the ICC properly determine whether the revenue shortfalls which captive traffic is being asked to offset through higher rates are (a) unavoidable (e.g., they are not attributable to poor management on the part of the railroads), and (b) fairly distributed among the various segments of traffic so that no particular segment (such as captive coal traffic) is forced to pay a disproportionate share of the additional revenues needed to achieve the goal of revenue adequacy.

In the 33 months which have passed since enactment of the Staggers Act, there is no indication that the ICC has given any genuine effect to the provisions of the Long-Cannon Amendment, or that it has any intention of ever doing so. Instead, the ICC has created a classic Catch-22, whereunder shippers are effectively robbed of the use of the Long-Cannon criteria, thereby freeing the ICC from the statutory requirement that these criteria be addressed in maximum rail rate cases. This Catch-22 has been achieved through the Commission's imposition of the burden of presenting evidence relative to the Long-Cannon criteria on shippers on the one hand, while refusing shippers' requests that the railroads be requried to divulge data necessary to address these criteria—data which in most cases is solely in the railroads' possession—on the other.

Early in 1982, a number of parties petitioned the ICC to institute a rule making proceeding to implement the provisions of Long-Cannon Amendment. The reason was quite simple: without the availability of an appropriate data base, it is not possible to render adequate findings regarding such factors as traffic mix, unavoidable revenue shortfalls, non-compensatory traffic, any individual carrier has, what effort has been made to maximize revenues on marginal traffic, or which captive traffic is bearing what proportionate of the revenue shortfalls which are alleged to exist.

The ICC responded with a decision served September 3, 1982 in Docket No. 38754, Arkansas Power & Light Company, et al., Petition to Institute Rulemaking Proceeding—Implementation of Long-Cannon Amendment to the Staggers Rail Act. In that decision, the ICC refused to institute a rulemaking, or any other type of investigatory proceeding, related to the development of a data base and a presentation methodology for use in connection with the Long-Cannon Criteria. The ICC reasoned that since the Staggers Act was a "deregulatory" statute, it would be contrary to the Act's purpose to promulgate additional rules to implement one of its provisions.

The Commission then went on to allocate burdens of proof with respect to the Long-Cannon criteria, notwithstanding the fact that it is universally acknowledged that the rail carriers alone possess most of the information necessary to address these criteria competently. In rate investigation proceedings beyond under 49 U.S.C. § 10707, the ICC said, the burden of proof would be on the railroad. This ruling offers little solace to captive shippers, however, since the ICC consistently refuses all requests for the institution of rate investigations. Captive shippers must instead seek to adjudicate their rights under the Interstate Commerce Act through the filing of a complaint under 11701, and for these proceedings the ICC determined that the shipper would bear the burden of presenting evidence responsive to the Long-Cannon criteria.

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[39] Annual Volume Rate on Coal—Wyoming to Flint Creek, Ark., 361 I.C.C. 533, 549 (1979).

Purporting to respond to shippers' arguments that only the carriers possess the data relevant to the criteria and consistently refuse to devulge it, the ICC stated that it would grant "reasonable" discovery requests by shippers. Unfortunately, in practice the system has not worked as the Commission indicated it would in its decison in Docket No. 38754. For example, in Docket No. 37911S, *South Mississippi Electric Power Association* v. *Louisville & Nashville Railroad Company and Southern Railway Company,* Decision served May 2, 1983, the ICC refused to require the defendant carriers to answer the complaining shippers' interrogatories concerning Long-Cannon data. The Commission accepted the carriers' argument that producing the requested data would require time-consumming "special studies," and held that the shipper's requests were too broad, since they applied to each carrier's entire traffic base. Apparently, the ICC has forgotten that the Long-Cannon criteria require, among other things, that one examine a carrier's overall traffic base in order to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues. Similarly, one cannot determine whether certain traffic segments are transported at rates which do not contribute to going concern value, another of the criteria, unless all of a carrier's traffic can be examined in an effort to identify such segments.

Even in cases where a shipper has managed to make a preliminary showing regarding one or more of the criteria, the ICC has refused to open the door to meaningful access. Evidence submitted by the complainant in Docket No. 39002, *Utility Fuels, Inc.*, v. *Burlington Northern Railroad Co., et al.*, tended to show that BN's 1981 system "revenue shortfall" was $699 million. Of this amount, $315 million, or 45 percent, was attributable to traffic other than coal which moved at rates below variable costs. Less than 0.5 percent was generated by coal traffic below variable costs. This evidence, when combined with the fact that the average revenue-to-variable cost ratio on BN's coal traffic was 179 percent (compared to 117 percent on non-coal traffic), tended to show that BN's pricing practices resulted in coal traffic being forced to pay a disproportionate share of the BN's overall revenue needs.[40] Clearly, a legitimate question was raised whether BN's coal traffic was being used to cross-subsidize millions of dollars of non-compensatory traffic (traffic moving below variable costs)—the very concern reflected in the Long-Cannon criteria. Notwithstanding this proffer, however, the ICC refused to permit the shipper in Docket No. 39002 access to pertinent data regarding BN's internal pricing policies.[41]

Thus, the Catch-22. A shipper bears the burden of presenting evidence responsive to the Long-Cannon criteria, and without such a presentation the ICC will not evaluate a rate by reference to the criteria. Sufficient reason exists to suspect that many—if not most—carriers are using captive traffic to unlawfully cross-subsidize non-compensatory traffic. When a shipper attempts to obtain the data necessary to prepare such a presentation, however, the shipper is told that the burden of producing such data is too great to require the railroads to disclose the needed information. Congress' effort to balance the rate flexibility given to the railroads in the Staggers Act with firm guidelines to be employed by the ICC in evaluating the reasonableness of a challenged rate, has effectively been stripped of all significance in the present regulatory environment.

F. The need for congressional action

The Interstate Commerce Commission has totally abdicated its statutory responsibility to balance the interests of the nation's rail carriers with the need to maintain through regulation reasonable rail rates on captive—particularly coal—traffic. Further, the Commission as presently constituted, and based upon its most recent pronouncements, has no intention of reversing the current slide. If anything, it is likely to accelerate the administrative deregulation of captive rail rates. It therefore falls to the Congress to provide, through statute, firm standards and guidelines for future ICC action in the coal rate area.

We believe that the approach set forth in Section 2 of S. 1082 offers promise, and are prepared to endorse its passage at the present time. That section would address many of the major problems faced by captive rail shippers as they seek to adjudicate their claims of unreasonable rate treatment by: Making clear that the goal of railroad revenue adequacy is but one of many co-equal criteria to be considered in determining maximum reasonable rates; allocating the burden of presenting evidence responsive to the Long-Cannon criteria in a manner more consistent with the realities of data possession; and ensuring that those criteria play their intended, major role in all maximum reasonable rate determinations.

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[40] V.S. of John Anderson submitted in Docket No. 39002, May 20, 1983, at 15–17, 22–24.

[41] Docket No. 39002, Order served July 7, 1983.

It is indeed unfortunate that we must ask the United States Congress to force the ICC to recognize that which we believe Congress made plain in 1980: that the interests of shippers, carriers and the public are to be balanced in the regulation of railroad rates. Based upon the actions of the ICC in this area since enactment of the Staggers Act, however, we are faced with little choice.

III. MARKET DOMINANCE

A. Market dominance under the 4-R Act

The jurisdictional concept of market dominance was established in 1976 through the enactment of Section 202 of the Railroad Revitalization and Regulatory Reform Act of 1976 ("4-R Act"). Under that Act, "market dominance" was defined as "an absence of effective competition from other carriers or modes of transportation, for the traffic or movement to which a rate applies."

The 4-R required that the ICC promulgate, by rule, standards and procedures that would facilitate practical determinations of market dominance.[42] If, applying such rules, a rail carrier was found to possess market dominance over a given movement of traffic, then under the scheme instituted by the 4-R Act the ICC possessed jurisdiction to adjudicate the reasonableness of the rate charged by the carrier for the movement in question.

Congress adopted the market dominance test in order to "deregulate" rates in competitive markets, while retaining regulation over rates for those movements where effective competition did not exist. As explained by the Conference Report accompanying the 4-R Act, the market dominance provision: "is designed to permit rates to be set by the forces of competition in those situations in which effective competition exists." [43]

In addition, as repeated throughout the history of the 4-R Act, Congress intended that the ICC's market dominance rules "be designed to provide for a practical determination without administrative delay."

On October 1, 1976, the ICC issued its Final Order in Ex Parte No. 320, *Special Procedures for Making Findings of Market Dominance as Required by the Railroad Revitalization and Regulatory Reform Act of 1976*,[44] wherein it promulgated the rules required by the 4-R Act. Under the rules, a finding of market dominance would be triggered by a complaining shipper's demonstration of three fact patterns,[45] or by the shipper's showing that the rate in question had been established through a railroad rate bureau and the defendant carrier was unable to demonstrate the presence of effective competition for the traffic or movement.

The ICC also established specific procedures for considering issues of market dominance.[46] Finally, the ICC reaffirmed its earlier finding that the statutory definition of market dominance and Congress' intent regarding application of the concept limited the scope of consideration to direct transportation competition for the traffic or movement in question. Consideration of potential geographic or product competition [47] was found to be precluded by the language of section 202 and the intent of Congress regarding expeditious, practical determinations of the threshold jurisdictional question.[48]

The Commission's Final Order in Ex Parte No. 320 was reviewed by the United States Court of Appeals for the District of Columbia Circuit in *Atchison, Topeka & Santa Fe Railway Co.* v. *I.C.C.*, 580 F.2d 623 (D.C. Cir. 1978). The Court of Appeals upheld the Commission's Order in all respects, subject to a further explanation (subsequently provided) of the level of the cost presumption.

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[42] Public Law No. 94-210, § 202(b) 90 Stat. 31 (1976).

[43] Senate Report No. 94-595, 94th Cong. 2d sess. 148 (1976).

[44] 355 I.C.C. 12 (1976).

[45] The three fact patterns giving rise to a presumption of market dominance were:

(1) Where the proponent carrier had handled 70 percent or more of the involved traffic during the preceding year; the market share of the proponent will be deemed to include the share of any affiliates, and of any carrier participating in the rate or with whom the proponent carrier had discussed considered or approved the rate in issues;

(2) Where the rate in issue exceeded the variable cost of providing the service by 60 percent or more; and

(3) Where affected shippers or consignees had made a substantial investment in rail-related equipment or facilities which prevented or made impractical the use of another carrier or mode.

[46] These procedures set forth in specific and mandatory terms the evidence which parties were to present, the form such evidence should take and when such evidence was to be presented. *See* 355 I.C.C. at 22-23.

[47] As defined by the Commission: "product [competition] refers to the shipper's or receiver's option to use commodities which are interchangeable for the commodity named in the issue tariff. Geographic competition is shipper use of alternative destinations or sources of the products to which the rate applies."

[48] See *Central Power & Light Co.* v. *U.S.*, 634 F.2d 137, 174 (5th Cir. 1980).

Following their promulgation, the Commission began applying its market dominance rules in maximum rate reasonableness cases. The practical effect of the application of these standards, according to the Commission, was a substantial lessening in the number of rates over which the Commission exercised its regulatory jurisdiction.[49] Later, the Subcommittee on Oversight and Investigations of the House Committee on Interstate and Foreign Commerce issued a report praising the ICC's implementation of the market dominance regulations.[50]

B. The new guidelines

In December, 1980, two months after enactment of the Staggers Act, the ICC—citing the Act as new authority—proposed to do away with its four year-old market dominance scheme.[51] It also proposed—in an about-face from its prior reading of the law—to use evidence of potential geographic and product competition in making market dominance determinations

In its final decision in Ex Parte No. 320 (Sub-No. 2), the Commission adopted its initial proposal to use geographic and product competition in making market dominance determinations; its proposal to abolish rebuttable market dominance presumptions; and its proposal to exclude, or place limited weight on, evidence that would formerly have invoked those presumptions. In place of the presumptions, the Commission set forth a long list of "evidentiary criteria," which it called "guidelines for submitting evidence." These guidelines (which are in effect today) are divided into four categories: intramodal competition, intermodal competition, geographic competition and product competition. Thirty criteria are listed under these four headings. Simultaneously with its order in Ex Parte No. 320 (Sub-No. 2), the Commission issued an oreder in Ex Parte No. 320 revoking the existing market dominance regulations. This radical repudiation of the procedures developed under the 4-R Act—procedures which bore a court's and a Congressional Committee's stamp of approval—took place solely in reliance on the "new statutory framework" purportedly wrought by the Staggers Act's amendments.

C. The ICC's present policy is inconsistent with congressional intent

The principal deficiency of the current "guidelines" approach lies in the ICC's conclusions regarding geographic and product competition. In support of its change of heart on this issue, the ICC fell back on "relevant sections" of the Staggers Act (though they remained unidentified). In point of fact, however, the Staggers Act offers no support whatsoever for the ICC's decision. Quite the contrary, the legislative history of the Act reveals that Congress recognized that the definition of market dominance in the 4-R Act excluded geographic and product competition. Moreover, Congress specifically rejected measures which would have included such factors in determining ICC jurisdiction in favor of retaining the then-existing market dominance definition.

Under the 4-R Act, market dominance was defined as an "absence of effective competition from other carriers or modes of transportation for the transportation to which a rate applies." [52] The ICC's Ex Parte No. 320 (Sub-No. 2) "guidelines" maintain that this definition allows for the consideration of geographic and product competition. Such an interpretation, however, is in direct conflict with both the language of the 4-R Act and the legislative histories of that Act and the Staggers Act.

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[49] See, Implementation of the 4-R Act, Hearing Before the Subcomm. on Surface Transp. of the Committee on Commerce, Service and Transp. of the United States Senate, S. Rep. No. 96-5, 96th Cong. 1st Sess. 46 (1979) (Statement of Hon. A. Daniel O'Neal). Chairman O'Neal noted that "between October 1, 1978 [the effective date of the market dominance rules] and December, 1978, the Commission precluded only 15 rate increases from taking effect out of several thousand filed and 267 protested [under what is now 49 U.S.C. § 10707]." (Id.) He went on:

"This is in significant contrast to the period just before the enactment of the 4-R Act, when investigations and suspensions of rail rates ran at much higher levels. For example, in the first months of 1975, we suspended 75 rate schedules out of 170 protested. And if you translate that to a 2-year period, that would be 300 suspensions as opposed to 15 in the 2-year period after the act became effective.

"Quite clearly, the market dominance concept [combined with procedural standards set forth in 4-R Act § 202] have had a very great effect on rate and ratemaking where traffic is competitive." Id. at 58.

[50] Committee Print 96-I.F.C. 40 (February 1980)

[51] Ex Parte No. 320 (Sub-No. 2), Market Dominance Determinations and Consideration of Product Competition, 45 Fed. Reg. 83342 (1980).

[52] 49 U.S.C. § 10709(a). This definition was left unchanged by the Staggers Act.

In Ex Parte No. 320 (1976), the ICC concluded that the statutory definition of market dominance left no room for consideration of geographic and product competition. This finding was approved by the D.C. Circuit and by a Congressional subcommittee charged with ICC oversight. Such approval was well-founded, since the very words of the definition belie any suggestion that geographic and product competition may be considered. The definition speaks of effective competition for the transportation to which the rate applies. This clearly contemplates direct competition for that specific traffic movement.[53] The focus of the market dominance determination, therefore, must be whether a shipper has a choice between carriers, both of whom provide the same commodity service from the same origin to the same destination.[54]

Geographic and product competition, however, do not focus upon such direct competition. Geographic competition arises from the ability of a rail customer to obtain the same commodity from a different origin, or its ability to transport such a commodity to a different destination. Product competition, on the other hand, refers to the availability of different commodities that may be interchangeable with that to which the rate under consideration applies. Both concepts refer to indirect, nontransportation competition. In a hypothetical movement of commodity 1 from point A to point B, the rate under scrutiny will not apply to a shipment from point C to point B, or from point A to point D. The Commission recognized this logical fact in Ex Parte No. 320:

"There is no language in the legislation which would warrant extension of the phrase 'the traffic or movement to which the rate applies' beyond transportation services which are comparable to that described in the issue tariff." [55]

Under the 4-R Act, it is clear that consideration of geographic and product competition is precluded by the language and intent of section 202. The words of the Staggers Act did not alter that language; yet, it is the ICC's position that the "intent" of the Staggers Act did.[56] The legislative history of that Act clearly demonstrates that the Commission's position is incorrect.

The legislative history of the Staggers Act really begins with the Oversight Subcommittee hearings on the ICC's implementation of the 4-R Act. Prior to those hearings, the Commission issued a decision in Docket No. 37226, Incentive Rates on Coal—Axial, CO to Coleto Creek, TX, (January 15, 1980). There the ICC, for the first time, based it market dominance determination on a finding of the existence of geographic competition. Even though the shipper involved was locked into a long-term coal supply contract with a single origin served by a single carrier, the Commission found that that carrier did not possess market dominance due to potential geographic competition. While the decision was reversed on appeal by the Fifth Circuit,[57] hearings were held in the interim, and the House Subcommittee found the ICC's departure from the settled definition of market dominance shocking:

"Coleto Creek represents a violation of the fundamental mandate of the 4-R Act. . . . If allowed to stand, this decision would severely erode protection for captive shippers which Congress sought to ensure." [58]

In the initial stages of Congressional deliberations on the Staggers Act, both the Senate version (S. 796) and the House bill (H.R. 7235) contained provisions that would have injected consideration of geographic and product competition into the concept of market dominance. After hearings, during which both shippers and carriers expressed strong displeasure with the proposed legislation, the Senate rejected S. 796 in favor of S. 1946. Introduced by Senators Long, Packwood and Cannon, S. 1947 specifically excluded geographic and product competition, substituting a revenue-to-variable cost test. In the final version of S. 1946 adopted by the Senate, geographic and product competition were left out of the provision concerning market dominance.[59]

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[53] Increased Rates on Coal, BN, Montana to Superior, Wisconsin, 362 I.C.C. 625 (1980). There, the ICC clearly acknowledged that the relevant issue was competition for "the specific transportation services under consideration." Id., at 634-35.

[54] See, *Atchison T. & S. F. Ry. Co.*, supra, at 634.

[55] 353 I.C.C. at 904-5.

[56] It should be noted that the ICC's statement on Congressional "intent" was brought before the U.S. Court of Appeals for the Fifth Circuit on rehearing in *Central Power & Light Company* v. *United States*, 639 F.2d 1164 (5th Cir. 1981). In addressing the railroads' claim that the December 1980 Notice of Proposed Rulemaking in Ex Parte No. 320 (Sub-No. 2) contained the "reasoned explanation" of why geographic competition could be considered that the Court required in its earlier decision in the same case, the Fifth Circuit stated: "The proposal which respect to geographic competition is very cursory and tentative and does not appear specifically addressed to the problem we perceive, i.e., and unexplained change in the Commission's treatment of geographic competition." 639 F.2d 1104, 1107. In its final decision in Ex Parte No. 320 (Sub-No. 2), the Commission did not improve upon its December, 1980 "explanation." Instead, it merely added its bald statement concerning the "intent" of the Staggers Act.

[57] *Central Power & Light Company* v. *United States*, 634 F.2d 137 (5th Cir. 1980).

[58] Oversight Report (Committee Print 96-I.F.C. (February 1980)), at 83.

On the House side, geographic and product competition took the form of a "reasonable transportation alternative" provision in section 202 of H.R. 7235. An amendment to that bill, offered by Representative Eckhardt of Texas, however, eliminated that provision in favor of the existing definition of market dominance.[60] As stated during the debate on the Eckhardt amendment:

"What the amendment of the gentleman will do is to scrap this concept of this reasonable transportation alternative. . . . The gentleman is scrapping the concept of reasonable transportation alternatives and is substituting in its place . . . the concept of market domination that was put into the 4-R Act." [61]

The Eckhardt amendment was adopted by the full House, and while some of its provisions were later watered down in what became known as the Staggers-Rahall-Lee Compromise, the 4-R Act's market dominance standard was retained intact as the basic jurisdictional test. As noted by Chairman Staggers of the House Interstate and Foreign Commerce Committee:

"I am pleased at the Rahall-Staggers Compromise response to the expressed needs of agriculture so fully. First, removing the 'reasonable transportation alternative test and retaining existing law on market dominance." [62]

When the representatives of the Senate and House joined in conference to blend their separate bills into the legislation that was signed into the law by President Carter as the Staggers Act, they left no doubt that geographic and product competition were not to be a part of the market dominance determination:

"The definition of market dominance under existing law has not been altered by the [Staggers Act] and it is not intended that there be any change in the meaning of the term." [63]

It is clear that Congress specifically considered and rejected the addition of geographic and product competition considerations to determinations of market dominance. Nevertheless, the ICC in Ex Parte No. 320 (Sub-No. 2) took it upon itself to inject these considerations into the market dominance test, citing vague assertions of Congressional "intent" as purportedly reflected in the Staggers Act. The legislative history of the Staggers Act, however, demonstrates that the Commission's action directly contravenes the will of Congress.

D. The ICC's present policy is impractical

In addition to its infirmities in connection with the language and legislative history of the definition of market dominance, the ICC's current position on geographic and product competition is inconsistent with the statutory directive that the market dominance standard be a practical, threshold test. The ICC itself recognized that: "Determining whether [geographic and product competition] have a significant impact in a particular case would require lengthy antitrust type litigation, as the interplay which affects competition for the sale of a product and competition for transportation services is very complex." [64]

As the ICC noted in 1976, the legislative history of the 4-R Act made it clear that "lengthy antitrust type proceedings are not contemplated in deliberations of market dominance.[65] Four years later, however—with no intervening substantive change in the statute in question—the ICC reversed itself and began following a course which produces the very type of proceedings recognized as inconsistent with the law.[66] The complexity of the issues is exacerbated by the fact that in most cases the ICC is dealing with nothing more than speculation concerning the potential for product or geographic competition. Even in antitrust cases, claims involving potential competition stand out as uniquely difficult from an evidentiary perspective.[67]

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[59] See 125 Cong. Rec. S. 3271-3320 (Daily ed., Apr. 1, 1980); Senate Committee on Commerce, Science and Transportation, 96 Cong. 1st Sess. (1979); Report on S. 1946—Railroad Transportation Policy Act of 1979 (S. Rep. No. 96-470).

[60] 126 Cong. Rec. H. 6415-6429 (daily ed., July 24, 1980).

[61] Id., at 6418-19, Remarks of Rep. Florio.

[62] Id., at 8549 (daily ed., Sept. 9, 1980) (Remarks of Rep. Staggers).

[63] H.R. Rep. No. 96-1430, 96th Cong. 2nd Sess. 88 (1980).

[64] Ex Parte No. 320, 353 I.C.C., at 905.

[65] 353 I.C.C., at 933.

[66] Testifying in 1981 on the subject of market dominance, two railroad witnesses stated that the Ex Parte No. 320 (Sub-No. 2) formula "makes the determination of market dominance in ICC proceedings virtually identical to the determination of market power in antitrust cases." V.S. of Richard A. Posner and Robert S. Stillman in Docket No. 37021, Annual Volume Rates on Coal—Rawhide Junction, WY to Sergeant Bluff, Iowa and Docket No. 37209, Iowa Public Service Co. v. Burlington Northern Inc., August 24, 1981.

At the time the market dominance test was being formulated by the Senate Commerce Committee, it was explained that:

"The market dominance test is not designed to be an ultimate regulatory standard. Instead it is designed as a threshold test to direct the Commission's regulatory activities into areas above the public interest needs protection." [68]

To implement the test, the ICC was directed to establish standards and procedures "designed to provide for a practical determination without administrative delay." [69] This language was specifically added in order to: "abate in substantial part the ICC's previously expressed concerned regarding its ability and the danger of becoming bogged down in antitrust-type litigation." [70]

Consideration of geographic and product competition in market dominance proceedings initially guarantees that what was intended to be a "threshold test" will turn into the "antitrust type litigation" which Congress specifically strove to avoid.

The manifest purpose of the market dominance concept was to facilitate an early determination of the existence of competition for the traffic that is subject to a challenged rate—and thereby determine ICC jurisdiction over that rate. The standards for such a determination were to provide for the easy identification of those markets where carrier dominance existed.[71] Equally clear was the fact that such a determination was not to involve detailed market studies conducted on a case-by-case basis. Rather, the ICC's authority to promulgate rules was an integral part of section 202 of the 4-R Act, and was counted upon to guard against protracted, complex market dominance proceedings:

"Lengthy anti-trust type litigation will be avoided by virtue of the Commission's authority to adopt rules of practical application which will identify markets in which dominance exists." [72]

The ICC itself—correctly—observed the importance of procedures allowing for a "practical determination." [73]

"Evidence must be promptly gathered and measured against practical substantive standards for decisionmaking.

* * * * * * *

"[A] complete case by case would allow for a practical determination without administrative delay." [74]

There is no doubt that the Ex Parte No. 320 rules and procedures achieved the result contemplated by the 4-R Act, due in large part to the Ex Parte No. 320 presumptions and the ICC's decision not to consider evidence of potential goegraphic and product competition. The court in *Atchison, T. & F. S. Ry. Co.* v. *U.S.,* noted that the "clear emphasis place by the [4-R Act] upon efficiency and practicality" was well met by the exclusion of such evidence; such exclusion ensured that the complexity inherent in potential competition evidence "will not create delay in the determination of market dominance." [75]

The enactment of the Staggers Act did nothing to change the existing emphasis on administrative practicality. This is demonstrated by the fact that under current law, the Commission has but 90 days to render a decision on market dominance in rate investigation proceedings.[76]

In its decision in Ex Parte No. 320 (Sub-No. 2), the ICC completely abdicated the responsibility placed upon it by Congress in the 4-R Act. Its "guidelines" and its invitation to the submission of evidence on geographic and product competition have served to create the very protracted, "anti-trust type litigation" that Congress so clearly eschewed.[77]

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[67] Cases decided under the Ex Parte No. 320 (Sub-No. 2) standard have become mired in extensive discovery with respect to market dominance. For example, attached to this statement as Appendix B is a set of interrogatories served by railroad defendants in complaint cases brought under Section 229 of the Staggers Act. An examination of these interrogatories illustrates, in practical terms, the deleterious impact of the ICC's Ex Parte No. 320 (Sub-No. 2) "guidelines" on the sound administration of the Interstate Commerce Act.

[68] Senate Report No. 96-499, 94th Cong. 2d Sess. 47 (1975).

[69] 4-R Act, § 202(d).

[70] Ex Parte No. 320, 353 I.C.C. at 943.

[71] Ex Parte No. 320, 353 I.C.C. at 886.

[72] Senate Report. No. 94-499, 94th Cong. 1st. Sess. 47 (1975).

[73] In fact, it was the ICC that injected the "practical determination without administrative delay" language into the initial versions of the 4-R Act. See Hearings on S. 2265 Before the Subcomm. on Surface Transportation of the Senate Committee on Commerce, 94th Cong. 1st Sess., part IV, 1513, 1905 (1975).

[74] Ex Parte No. 320, 353 I.C.C. at 930, 933.

[75] 580 F. 2d at 634.

[76] 49 U.S.C. § 10709(b). In rate suspension proceedings, the time limitation is even more strict. 49 U.S.C. § 10762(c)(3).

Market evaluations by the ICC under its Ex Parte No. 320 (Sub-No. 2) guidelines involve some of the most difficult and miasmic issues of antitrust law, issues which the ICC is neither designed nor staffed to resolve and which Congress never intended to be a part of the market dominance determination. Referent case law indicates that even ascertaining the bounds of a relevant geographic market can become an administrative nightmare. *See e.g., Brown Shoe Co.* v. *U.S.,* 370 U.S. 294 (1962). Examinations of market behavior, business trends and production capacity create a further morass through which the Commission (and parties to proceedings) have to tread under the present policy. See *U.S.* v. *Falstaff Brewing Corp.,* 410 U.S. 526 (1973). In addition, the statutory time limitations by necessity reduce the Commission's intention to look at potential competition [78] to an exercise in mere speculation.

The outlook is bleak enough with respect to rate challenges by coal shipper/receivers. In cases involving shipper/producers, however, the scenario takes on increased complexity. For example, it is necessary to determine the number, location and substitutability of a producer's potential customers.[79] This task alone could prove to be interminable. Once such potential competition for the producer's existing customers was determined (if indeed it could be), the question whether such competition was effective must then be addressed. Under the Commission's guidelines it would be the producer's burden to show that such competition was not effective. Few possess the resources to finance such a market study. At a maximum, the prospect of having to undertake such a monumental task will have a chilling effect on shipper/producer efforts to pursue their rights to invoke the ICC's power to hold rates to a reasonable maximum. In many cases, in fact, the costs of such an effort may preclude what would otherwise be a meritorious rate challenge.

In a proceeding denominated as Ex Parte No. 320 (Sub-No. 1), Rail Market Dominance and Related Considerations,[80] the ICC stated:

"[O]ur regulations must be clear and simple and must reflect our actual policies. To the extent possible, the standards should be definite enough to permit prediction of the market dominance decision given a particular factual situation." [81]

The ICC's current Ex Parte No. 320 (Sub-No. 2) guidelines are in no way clear and simple. They represent the very antithesis of rules designed to provide definition and certainty, and are simply a return to the "case-by-case" approach which, in 1976, the ICC said "would not allow for a practical determination without administrative delay." [82]

E. The fifth circuit's review and the need for legislation

In light of the foregoing and for a number of additional reasons as well, it was not too surprising that a panel of the U.S. Court of Appeals for the Fifth Circuit, in a decision issued December 8, 1982, ruled that the ICC's inclusion of potential geographic and product competition in analyses of carrier market dominance "violates the limits contained in the statutory definition and is invalid." [83] The court's decision, however, was based solely on its reading of a single phrase of the definition, and the court did not go beyond the language of the statute to address any of the numerous other infirmities in the ICC's Ex Parte No. 320 (Sub-No. 2) decision—many of which have been catalogued in this testimony (since its finding warranted remand to the ICC anyway, it deemed delving into any other issues unnecessary).

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[77] In this regard it should be noted that six months after the Ex Parte No. 320 (Sub-No. 2) decision, ICC Chairman Reese Taylor expressed serious doubt whether the new "guideline" approach was consistent with the Congressional mandate:

"I must question whether the new evidentiary criteria is consistent with our original Congressional mandate that we establish 'standards and procedures' that, with regard to market dominance, will permit 'a practical determination without administrative delay.' * * *

"I must also profess reservations as to the practical application of geographic and product competition in market dominance determinations."

Ex Parte No. 320 (Sub No. 2), Decision served Oct. 28, 1981 on petition for reconsideration (separate expression of Chairman Taylor).

[78] Ex Parte No. 320 (Sub-No. 2), 365 I.C.C. at 130–32.

[79] Under the Commission's guidelines, the carrier has to make this threshold showing. Regardless of where the burden lies, however, the massive drain on time and resources necessary for such a determination remains the same.

[80] 45 Fed. Reg. 3353 (Jan. 17, 1980).

[81] *Id.,* at 353–54.

[82] Ex Parte No. 320, 353 I.C.C., at 930.

[83] *Western Coal Traffic League* v. *United States,* 694 F.2d 378 (5th Cir. 1982).

Upon petition of the ICC and the railroad industry, the Fifth Circuit granted en banc rehearing of the case, and supplemental briefs were submitted on April 6, 1983.

If the Fifth Circuit panel's decision on the question of geographic and product competition is affirmed, Congressional action will still be needed in order to address the ICC's "laundry list" approach to market dominance findings. Its current guidelines clearly do not rise to the level of rules, a required by the 4-R Act, and its 30-odd factor list fails to provide the definition and predictability necessary for (a) evaluations by parties prior to litigation in order to discern whether a basis for ICC jurisdiction exists, and (b) expeditious, practical ICC determinations of jurisdiction once litigation does begin, determinations made "without administrative delay" and the protracted, complex proceedings associated with "antitrust-type litigation."

If the panel's decision is reversed, immediate legislative action would be crucial to the preservation of shipper access to the ICC for adjudication of maximum reasonable rate disputes. Pending rehearing, the ICC's Ex Parte No. 320 (Sub-No. 2) guidelines have remained in effect, and it is clear that under these guidelines shippers and other rail customers are being deprived of meaningful access to ICC rate review. In a recent decision involving the Aluminum Association, for example,[84] the ICC reversed an earlier ALJ finding that the defendant carriers possessed market dominance over the aluminum ingot traffic there in issue. The ICC applied its Ex Parte No. 320 (Sub-No. 2) guidelines, and made this finding of no market dominance despite the facts that: Parallel pricing by the carriers involved eliminated any potential intramodal competition; over 90 percent of the ingot traffic was transported by rail, and weight and distance considerations precluded truck carriage; the majority of the ingot in question could not be substituted for by alternate products; and the production/demand factors indicated that changes would require an almost total restructuring of the aluminum industries' established patterns of production and distribution of ingot.

The centerpiece of the ICC's decsion was its finding that so long as any portion (however small) of the traffic might be diverted or stopped in the event of unreasonably high rates, "effective competition" could be said to exist.[85] As a result of this decision, (which was only reached after a federal district court placed a time limit on the ICC's seemingly endless deliberations—the ALJ decision was rendered on August 5, 1981), rail movements of aluminum ingot from 16 different origins to 163 separate destinations are effectively deregulated, with the 54 carriers involved free to charge any rates they wish without fear of constraint or ICC scrutiny. Further, because the complaints in question were governed by Section 229 of the Staggers Act, the rates challenged therein any never be the subject of future litigation before the ICC, regardless of what changes may later occur in the aluminum transportation environment. It is now "open season" on innumerable aluminum ingot shippers and receivers.

An even more recent decision involving Consumers Power Company is also instructive.[86] There, an Administrative Law Judge reviewed the evidence submitted on the question of market dominance, and indicated his inclination to find that market dominance did indeed exist. He proceeded, however, to take note of the ICC's prior *Aluminum Association* decision—in particular that portion wherein the ICC held that "for effective . . . competition to be present" shippers need only have the capability of diverting a portion (not even a majority) of the traffic in question to other carriers or modes. The ALJ then characterized the ICC's current approach to market dominance thusly:

> "In order to avoid having to render a determination as to the maximum reasonable level of rates on aluminum ingot in [Docket No.] 37466, the Commission has it appears again foreclosed shippers from finding an avenue to complain of the level of rates they are assessed as claimed captive shippers. The decision in *Aluminum Association, supra,* and its expected application to other complaint proceedings involving claimed unreasonably high rates, will end the usefulness of this Commission to the body of rail shippers." [87]

In light of the prior decision, the ALJ concluded, there seemed little point in continuing his analysis. He then stated, with admirable candor:

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[84] Docket No. 37466, *The Aluminum Association, Inc.* v. *The Akron, Canton & Youngstown Railroad Company, et al.*, decision served June 8, 1983.

[85] Id., at sheet 12.

[86] Docket No. 37875S, *Consumers Power Company* v. *Norfolk & Western Railway Company, et al.*, Decision served July 1, 1983.

[87] Docket No. 37857S, at sheet 4.

"I see no reason or legal justification to force the shipper complainant and defendant rail carriers to continue this proceeding to the next stage in this bifurcated proceeding, the stage of reasonableness. Since the complainants and defendants are faced at each stage with the gathering of evidence that requires each party to expend a large sum of time, energy and money, it would appear a needless expenditure of funds etc., for both parties to be required to continue this exercise when the policy decision appears to have already been made." [88]

The message contained in the Consumers Power decision is very simple and, we submit, right on target: the ICC's current interpretation of market dominance and its Ex Parte No. 320 (Sub-No. 2) guidelines have rendered illusory the rail shipper rate protections preserved by Congress in the Staggers Act. Congressional action is imperative if the erosion of shippers' rights to access to the ICC resulting from the Commission's implementation of the market dominance concept is to be checked.

Section 5 of S. 1082 addresses most of the major problems with the ICC's present market dominance policy quite effectively. This provision would replace the ICC's amorphous "laundry list" with a short series of specific, defined and predictable criteria. In addition, it would make clear that the essential question in a market dominance determination is the presence of effective, direct transportation competition, and that potential geographic and product competition are beyond the proper scope of consideration. We endorse this provision as an adequate guide for future market dominance determinations, and encourage its enactment in order to preserve effective rail shipper access to the ICC's rate review forum.

IV. RAIL COST ADJUSTMENT FACTOR

Section 203 of the Staggers Act (now codified as part of 49 U.S.C. § 10707a) permits rail freight rates [89] to be increased on an individual basis, four times a year, by the percentage increase in an index of railroad costs to be compiled or verified by the ICC (the "cost adjustment factor").[90] Such increases are totally immune from shipper challenge, and purport to replace the ex parte general increases used in the past by the rail industry to adjust rates upward in response to rising service costs.

On April 17, 1981, the ICC issued a decision in Ex Parte No. 290 (Sub-No. 2), Railroad Cost Recovery Procedures,[91] wherein it announced that rather than compile its own index for purposes of section 203, it would use the "Index of Railroad Material Prices and Wage Rates"—the so-called "AAR Index"—compiled by the Association of American Railroads.[92] As the name implies, the AAR Index is a weighted index of the prices the nation's railroads pay for purchased materials, and the wage rates they pay their employees.[93] As such, it is an index of the railroads' input price increases, and not their output cost increases. Unless the index is adjusted to reflect the dampening effects of changes in productivity, traffic volume, traffic mix and the compostion of labor and material inputs on the cost of producing each unit of output, the AAR Index overstates the rate increases actually needed by the railroads to yield additional revenues sufficient to cover increases in the cost of providing service.

When the ICC first announced the proposal adopted in its April 17, 1981 decision in Ex Parte No. 290 (Sub-No. 2), shippers and other parties immediately pointed out that the failure of the proposed methodology to include a mechanism for adjusting the AAR index to reflect changes in productivity was a crucial flaw which would result in an over-recovery of rail cost increases—in direct contravention of the clear purpose of section 203. The ICC, "question[ed] the reliability" of such an adjustment.[94] It also opined that "as a matter of policy" it did not believe that a productivity adjustment was justified.[95] The ICC objected that a productivity adjustment might reduce the railroads' incentives to improve their productivity; that it could penalize railroads with worse than average productivity improvements even though their poor performance might be due to circumstances beyond their control; and would run counter to the goal of revenue adequacy. Based upon this rationale—even though the ICC *acknowledged* the correctness of the shippers' arguments [96]—The Commission refused to require adjustments in the AAR Index to account for changes in productivity. In other words, the ICC recognized the error, but since the "only" effect was to allow higher rail rates it chose to do nothing about it.

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[88] Id., at sheets 4–5.

[89] Certain rates on recyclable materials are an exception; section 204 of the Staggers Act forbids increases in such rates above a specified level.

[90] The rate increase mechanism created by section 203 consists of "base rates" and "adjusted base rates." "Base rates" are defined as the rates actually in effect on Oct. 1, 1980, Oct. 1, 1982, Oct. 1, 1984, and every fifth October 1 thereafter. 49 U.S.C. § 10707a(a)(1)(A). "Adjusted base rates" are defined as the applicable "base rates," multiplied by the rail cost adjustment factor or "cost recovery index." 49 U.S.C. § 10707a(a)(2).

[91] 364 I.C.C. 841 (1981).

[92] In a recent order served in Ex Parte, No. 290 (Sub-No. 2), the ICC announced its intent to replace the AAR Index with a new, "all inclusive" index, also developed by the Association of American Railroads. Comments have been sought. Id., Notice of Proposed Rulemaking served June 20, 1983.

[93] The AAR Index excludes certain inputs (such as purchased services and interest expenses) which comprise approximately 28 percent of railroad costs. The ICC chose to supplement it by using the Producer Price Index as a surrogate for the omitted expenses.

[94] 364 I.C.C. 846.

The use of an index that accurately reflects increases in output costs—rather than input prices—is imporant, because even a slight overstatement translates into an astounding number of dollars. For example, the total freight revenues of the nation's Class I railroads in 1979 were $23,447,418,000.[97] If input prices as measured by the AAR index increased at a rate of, say, 10 percent per year, while productivity improved at a rate of, say, 2.5 percent per year, the unwarranted rate increases permitted under the Index would be about $580,000,000 in the first year alone.[98] The overstatement of costs would, of course, be repeated and compounded in rate increases each succeeding year.

Faced with the prospect of being forced to pay substantial profit increases under the guise of cost recovery—increases totally immune from challenge before the ICC or the courts—numerous shippers and shipper groups petitioned the U.S. Court of Appeals for the D.C. Circuit for review of the ICC's decision. On May 4, 1982, the court affirmed the Commission's decision to omit a productivity adjustment "at this time." [99] The court agreed with shippers that "the principal function of the section 203 inflationary cost index is to provide a mechanism for recovering inflation-based costs, not to enhance revenues." However, the court went on to conclude that:

"Within the present state of the art—at least as reflected in this record—the difficulties of accurately measuring productivity growth on a current basis, coupled with the Commission's assessment of the importance of assuring railroads unencumbered rate increases to cover increased costs, support the Commission's conclusion that a productivity adjustment is inappropriate under present circumstances." [100]

Notwithstanding its affirmance of the Commission's decision, the court squarely rejected the Commission's "policy" reasons for omitting a productivity adjustment.[101] It stressed that although it was approving the Commission's decision not to implement a productivity adjustment in its "initial" indexing methodology, it expected that:

"In accordance with its stated intentions, the Commission will continuously review the accuracy of its chosen index and will revise the index in an appropriate fashion, *including consideration of measurable productivity gains*, as the circumstances warrant." [102]

It should no longer be open to dispute that the purpose of the cost recovery index is to permit expedited rate increases, free from regulatory scrutiny, *only* to the extent such increases are necessary to cover the effects of inflation on rail service costs. The index is not supposed to be a device for increasing railroad profits. The court's decision in *Western Coal Traffic League* v. *United States* has removed any doubt on that score. That the effects of productivity must be reflected in the index—in order that it may operate as a true measure of output cost increases—is a conclusion which logically flows not only from the D.C. Circuit's interpretation of the purpose of section 203, but from Congress' own clear intent as expressed in the language and legislative history of the provision.

One must begin with the pertinent statutory language. 49 U.S.C. § 10707a(a)(2)(B) states that:

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[95] Id.

[96] The Commission stated: "Once again, many parties contended that a productivity adjustment should be made. Their basic argument is that the AAR index, which is an index of the costs of railroad transportation inputs, necessarily overstates the increase in the cost of producing railroad outputs (transportation services), to the extent productivity increases occur. *We do not dispute the fact that productivity increases cause the costs of outputs to rise less rapidly than the costs of inputs; this is true by definition." 364 I.C.C. at 845-46 (emphasis added).*

[97] Association of American Railroads, "Yearbook of Railroad Facts" (1981 ed.), p. 13.

[98] Actual rate increase = 10 percent x $23.4 billion, or $2.34 billion; proper cost recovery increase = 7.5 percent (10 percent − 2.5 percent) x $23.4 billion or $1.76 billion; $2.34 billion − $1.76 billion = $580 million.

[99] *Western Coal Traffic League* v. *United States*, 677 F. 2d 915, 925 (D.C. Cir. 1982).

[100] Id. at 931 (emphasis added).

[101] Id. at 929-31

[102] Id. at 931 (emphasis added).

"Commencing with the fourth quarter of 1980, the Commission shall, as often as practicable but in no event less often than quarterly, publish a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published Index of Railroad Costs (which index shall be compiled or verified by the Commission, *with appropriate adjustments to reflect the changing composition of railroads costs, including the quality and mix of material and labor),* and the denominator of which is the same index for the fourth quarter of 1980. . . ." (emphasis added).

While the statutory language seems clear on its face, its legislative history removes any doubt that Congress specifically intended the use of an output cost index, rather than an input price index. The provision in question originated in S. 1946, the Senate bill which ultimately became the Staggers Act. As originally introduced by Senators Cannon and Packwood on October 29, 1979, S. 1946 contained (in § 103) the following provision: "As often as practicable, but in no event less often than quarterly, the Commission shall publish a rail cost adjustment factor which shall be a fraction, the numerator of which is the latest published *Index of Railroad Material Prices and Wage Rates* (which index shall be compiled or verified by the Commission) and the denominator of which is the same index for the fourth quarter of 1979." (emphasis added).

The "Index of Railroad Material Prices and Wage Rates" was, of course, the AAR Index.

The Senate Commerce Committee held five days of hearings on S. 1946 in November 1979.[103] At those hearings, witness after witness criticized the bill's choice of the AAR Index for inflation adjustment purposes, on the ground that it overstated the railroads' actual cost increases. For example, Mr. Ellis Cox appeared on behalf of the Edison Electric Institute on November 9, 1979, and stated that: "Adjusting rates by use of the AAR index will result in increases in rates which greatly exceed increases in costs. The AAR index is an index of prices—not of costs. This index appears to exceed cost increases by at least 25 percent, as explained in the statement of Gerald W. Fauth appended to this testimony." [104]

Mr. Fauth's prepared statement elaborated on Mr. Cox's point. Mr. Fauth explained that: "The AAR index is an index of prices—not an index of costs. Its use in this context is improper:

"1. It does not reflect increases in labor productivity. Increases in labor productivity have been very substantial in the past. From 1967 to 1978 the freight ton miles per employee increased by 36 percent. This trend is continuing. . . .

"3. The use of the AAR index assumes that all traffic uses the same mix of labor and materials. Use of the index is particularly inappropriate for escalating unit-train rates and trainload rates for coal because the service provided under such rates contains much less labor, plant and equipment per unit [than] does average traffic.

"4. The AAR index does not reflect the economies of scale resulting from an epanding [sic] volume of traffic.

"The western railroads have conceded that use of the index greatly overstates increases in costs. Existing escalation agreements are based on 80 percent of the index which strongly suggests that the index overstates cost increases by 25 percent. . . ." [105]

Finally, on the last day of hearings, Mr. Edmond B. Frost appeared on behalf of the Chemical Manufacturers Association. Like the witnesses who had preceded him, Mr. Frost criticized the bill's reference to the AAR Index:

"We approve of the intent of this section and the general concept of a cost passthrough. Any index used by the Commission should be based on actual variable costs incurred by the railroads. We note, moreover, that the passthrough formula provided in the bill ignores changes in traffic volume, labor productivity, fuel economy, and other factors bearing on cost per unit of output.

"Even the railroads agree that cost increases developed by the use of inflation indices should be diluted to take account of productivity gains. Some productivity adjustment should be added to the passthrough provisions of section 103. Passthrough rate increases should be based on increased cost per unit of output rather than cost per unit of input.[106]

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[103] See Railroad Transportation Policy Act of 1979: Hearings on S. 1946 Before the Senate Comm. on Commerce, Science, and Transportation, 96th Cong., 1st Sess. (1979) (hereinafter, "Senate Hearings").

[104] Senate Hearings, p. 428.

[105] Senate Hearings, p. 435.

[106] Senate Hearings, p. 529.

Mr. Frost's testimony elicited the following response from Chairman Cannon:

"With regard to section 103, you note that the formula set forth in S. 1946 doesn't specifically require consideration of such factors as changes in traffic volume and labor productivity, although it does call for Commission compilation or verification of any index.

"Several witnesses have suggested that in compiling the index, specific consideration be given to changes in volume, productivity, and traffic mix.

"I assume language along those lines, if adopted, would satisfy your concerns on that point." [107]

Mr. Frost responded affirmatively.

Consistent with Senator Cannon's remarks, S. 1946 as reported deleted the reference to the AAR Index, and in its place directed the ICC to compile or verify an "Index of Railroad Costs," with "appropriate adjustments to reflect the quality and mix of material and labor." [108]

This legislative history demonstrates that Congress focused specifically on the distinction between input prices and output costs, and unequivocally directed the Commission to reflect the latter in its cost recovery index. The ICC's adoption and continued use of the AAR Index—unadjusted for productivity—which it concedes overstates output unit cost changes to the extent of increases in productivity, directly flouts that Congressional mandate. Whatever "policy" reasons the ICC may have for using an unadjusted input price index, the plain fact is that Congress has directed it to do otherwise.

There is no doubt that a major (though by no means overriding) purpose of the Staggers Act was to facilitate efforts by the nation's railroads to increase their profits. To that end, the Act contained numerous provisions relaxing ICC regulation of rail rates.[109] The ICC seems to believe that the section 203 index should not be limited to cost pass-throughs, because one purpose of the Staggers Act was to improve railroad profitability. The ICC has failed to comprehend the limited role of the index, and it is—unfortunately—left to Congress to set matters straight (again). The Staggers Act has given the nation's railroads a potent arsenal of weapons to use in their fight for improved profitability. The cost recovery index, however, is not part of that arsenal. Its function is simply to reduce or eliminate "the time lag involved in recovering cost increases," [110] nothing more. Until the ICC modifies its cost recovery index to take changes in rail productivity and traffic mix into account, however, section 203 will continue to be a source of rail profit increases—in direct contravention of Congress' stated definition of its role and purpose.

It is true that the ICC has—since the D.C. Circuit's decision in *Western Coal Traffic League* v. *United States*—begun a proceeding ostensibly designed to solicit suggestions for the development of a methodology to make certain productivity adjustments to the AAR Index.[111] The original advanced notice of proposed rulemaking was served one full year ago (primarily in response to the admonition of the D.C. Circuit), however, and while numerous parties—including a collective of shippers and shipper groups—filed extensive comments containing proposed formulae in October 1982, the ICC has yet to even propose, much less adopt, a productivity adjustment mechanism. Characteristically, the ICC has let this highly important issue languish, while continuing to apply the admittedly inaccurate AAR input price index under the auspices of section 203.

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[107] Senate Hearings, p. 531 (emphasis added).

[108] Senate Report No. 96-470, 96th Cong., 1st Sess. 52 (1979) ("Senate Report").

[109] For example: § 216 permits rate increases to be filed on 20 days' notice, and rate decreases on 10 days' notice, in lieu of the prior 30-day notice requirement. § 208 expressly authorizes railroads to enter into rate contracts with their customers, and exempts such contracts (unless disapproved on limited grounds within 60 days after filing with the ICC) from rate regulation; § 212 sharply limits the bases upon which rail rates may be challenged as discriminatory; § 207 limits the power of the Commission to suspend proposed rate increases, and more importantly, provides for recovery of lost revenues by the railroad if a suspended rate increase is later found reasonable; § 217 authorizes surcharges on, and/or cancellation of, joint rates by carriers whose divisions thereof are non-compensatory; §§ 201 and 202 limit the Commission's maximum rate jurisdiction to those rates over which a railroad possesses market dominance, and which exceed costs by a specified (and escalating) percentage (thus, rates on competitive and/or low-margin traffic may be raised without ICC interference); and finally, § 203 provides for a zone of rate flexibility, above inflation-based increases, of 6 percent per year for the first 4 years (to a maximum of 18 percent), and 4 percent per year thereafter (for revenue inadequate carriers). Such additional increases are immune from pre-effective suspension.

[110] Senate Report, at 19.

[111] Ex Parte No. 290 (Sub-No. 4), Railroad Cost Recovery Procedures—Productivity Adjustment, 47 Fed. Reg. 32176 (July 26, 1982.)

It is clear that a productivity adjustment to the cost recovery index is necessary. It is equally clear that left to its own devices, the ICC cannot be counted upon to produce one in anything approaching a timely fashion. It is up to the Congress to lead the way, mandating both the acceptance of such an adjustment and the expeditious development of an appropriate mechanism. Enactment of Section 4 of S. 1082 would achieve the first, and strong accompanying language expressing Congress' displeasure with the ICC's foot-dragging the second. We would urge Congress to follow such a course as the best (and, perhaps, only reliable) means to obtain what all recognize to be a proper end.

V. RAILROAD ACCOUNTING PRINCIPLES BOARD

The last issue we would like to address in detail concerns the Railroad Accounting Principles Board. The development of accurate railroad service cost data is, of course, a crucial component in the operation of a number of important provisions of the Interstate Commerce Commission Act. Economically accurate rail cost evidence is central to determinations of ICC jurisdiction over individual railroad rates (49 U.S.C. § 10709(d)), the propriety of unilateral joint rate concellations or the imposition of rate surcharges (§ 10705a), the proper calculation of a carrier's investment base for purposes of revenue adequacy determinations (§ 10704), and findings regarding maximum (and minimum) rail rate reasonableness (§ 10701a(c)), among others. In addition, the availability of accurate service cost data plays a major role in rate contract negotiations and other extra-regulatory interactions between shippers and carriers.

One of Congress' major concerns as reflected in the Staggers Act was the development by the ICC of sound and reasonable railroad accounting principles. One entire title of the Act, Title III, was devoted to these concerns, as was one of the fifteen enumerated rail transportation policy goals.[112] Section 302 of the Staggers Act established a Railroad Accounting Principles Board, and directed it to develop and establish sound, tested principles to govern the determination of accurate carrier service cost data. As stated by the Committee on Conference, emphasis was to be placed on "economic accuracy for regulatory purposes," and the development of accurate, movement-specific costs was to be one of the Board's principal goals:

"The Conferees' intent is to provide for the most accurate possible statement of costs, both direct and indirect, associated with particular movements of goods, and the Board in developing its principles should consider the degree of reliability with which such costs can be attributed to specific movements." [113]

Congress' purpose in creating the Railroad Accounting Principles Board was indeed commendable, and considering the countless hours and dollars which have been spent by shippers and carriers alike battling over the question of accurate costing principles, such a source of before-the-fact resolution was long overdue. Unfortunately, the promise reflected in Staggers Act Section 302 has yet to be realized. The members of the Board (seven in all) were to be appointed by the Comptroller General, and an annual budget of $1 million was authorized, but in point of fact no funds were ever actually appropriated and no members were ever appointed. Today, the Board stands as the white elephant of the Staggers Act, and under Section 302 will expire altogether on October 1, 1983.[114]

Obviously, if Congress' intent as expressed in 1980 is to be carried to fruition, Section 302 (now 49 U.S.C. § 11161) must be legislatively extended and the appointment of its members mandated. Section 6 of S. 1082, as presently proposed, would adequately serve this purpose. Under the bill, the Comptroller General is required to appoint members to the Board within 120 days, and the "new" life of the Board is established as three years from the date upon which its members are appointed. It is our belief that once utilized, the Railroad Accounting Principles Board would be central to the achievement of substantive improvements in both the accuracy and efficiency of the rail service cost-finding process. Section 6 of S. 1082 would greatly facilitate this effort, and we therefore support the provision and urge its enactment.

VI. COMPETITION

Throughout my testimony thus far, I have referenced various provisions of S. 1082 as sufficiently responsive to the several serious problems caused by the ICC's one-dimensional interpretation of the Staggers Act. I do not wish to be read as saying, however, that the approach contained in S. 1082 is the only means by which captive shippers can obtain deserved relief from the ICC's excesses and the railroads' monopolistic pricing practices.

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[112] 49 U.S.C. § 10101a(14).

[113] H.R. Rep. No. 96-1430, 96th Cong., 2d Sess. 123 (1980).

[114] As originally envisioned, three years' time was seen as sufficient for the Board to develop, refine and establish sound costing and accounting principles, after which time—its task completed—it could be dissolved.

The organizations on whose behalf I am presenting this testimony wish to go on record urging consideration of additional efforts to achieve protection for captive shippers through the facilitation of increased competition in the rail transportation marketplace. Some proposals have surfaced which call for legislation designed to provide shippers with direct access to existing rail facilities for their own use, or to encourage head-to-head inter and intramodal competition. Mention has been made of amendments to the Sherman Antitrust Act, for example, and of amendments to the Interstate Commerce Act addressing such issue areas as trackage rights, joint rates and routes, reciprocal switching arrangments, etc. We welcome such proposals, and believe all deserve a full and fair hearing.

We do not take issue with the general proposition that regulation is not necessary where effective competition exists. Changes in the status quo which would introduce genuine and effective competition in the coal transportation market would be as refreshing as a return to balanced rail regulation, if not more so. In the last analysis, however, one must be certain that whatever pro-competitive measures are taken actually have their intended effect. Otherwise, one is left with no other choice than to pursue a regulatory reform program to ensure that Congress' goal of balancing the competing interests of shippers, carriers and the public is achieved.

This concludes my testimony with respect to the problems faced by captive coal shippers generally vis-a-vis the five major issue areas I identified at the beginning of my testimony. I would now like to turn briefly to the experiences of the public utility serving my home city of Hastings, Nebraska, in an effort to illustrate, in practical terms, the plight of captive coal receivers under the ICC's current implementation of the Staggers Act.

THE HASTINGS STORY

A. Background

Municipal generation of electric power in Hastings commenced in 1900. The City of Hastings has owned and operated a municipal electric generation and distribution system continuously since that time—it is called Hastings Utilities ("HU").

HU's electrical generation, transmission and distribution system now serves a service area of approximately 56.5 miles, comprising the seven and one half (7.5) square mile area of the City of Hastings and a forty-nine (49) square mile area adjacent to the city within Adams County, Nebraska, including the Village of Juniata.

Included within HU's service area are residential, consumer and industrial customers. The commercial and industrial businesses served are small and, outside of the City of Hastings, the economy is largely agricultural. All of HU's customers depend upon it to provide reliable service at reasonable rates. Many farms in the HU service area are especially depending on electrical service, because of their use of electrically-powered irrigation equipment to provide the water necessary to grow their crops.

The City of Hastings and HU are aware of the critical role that electricity plays in its customers' lives and its actions are always guided towards providing the secure, reliable and cost-effective services that these customers need and deserve.

During 1980, the HU electrical system had a peak hourly demand of sixty (60) megawatts, and sold a total of 174,814 megawatt hours of electricity to its customers.

B. The city of Hastings and the national energy crisis

Like most electric utilities, HU's problems with the nation's railroads must be traced to actions taken by HU to protect its customers from suffering irreparable injury as a result of our nation's energy crisis. I will not detail the events, starting with the OPEC Oil Embargo, which caused the crisis, because I am sure that the members of this Subcommittee are fully cognizant of the impact that the energy crisis has had on this nation, and particularly upon utilities which were reliant upon natural gas and oil as boiler fuels.

Hastings Utilities was one such utility. For years, it depended upon gas and oil to generate the electricity needed by its customers. To this end, HU owned and operated boiler units designed to use either oil or gas, or both. Prior to the advent of the energy crisis, HU rightfully believed that its reliance on oil and gas was best for its ratepayers because these fuels were both in abundance and could be obtained at reasonable prices.

The energy crisis changed all this. Commencing with the Oil Embargo, the cost of fuel oil skyrocketed. No longer could HU consider fuel oil to be a low cost fuel source. Heavy reliance on fuel oil would have caused severe and unwarranted increases in its customers' electric bills, a result that HU simply could not tolerate.

Increased price was not the only adverse consequence of the Embargo. The very availability of oil was also cast into doubt. The Oil Embargo showed us that the oil-producing nations could, and would, severely curtail our oil supplies whenever they so chose.

At the same time as the initial shock of the Oil Embargo was being felt, HU was informed by its sole natural gas supplier, Kansas-Nebraska National Gas Company, Inc., that it intended to cut off HU's supply of natural gas.

As a consequence of the Oil Embargo and the threatened shutdown of its sole source of natural gas, HU's ability to provide the low cost and reliable service it had traditionally given to the Hastings community was in serious jeopardy. Quick and decisive action was necessary to protect HU's customers. The City of Hastings took this action.

C. The decision to use coal

Given the real and dramatic problems associated with its continued reliance on oil and natural gas as principal boiler fuels, the City of Hastings had two alternatives. It could attempt to purchase needed power from others, or it could build a coal-fired plant.

After holding public hearings and carefully analyzing the results of its thorough research into its alternatives, the City of Hastings decided in 1977 to build its own coal-fired electric generating facility at a cost of seventy million dollars. Formal approval of this decision came on May 24, 1977, which marks the date that the City Council of Hastings adopted a resolution calling for the City to pursue all necessary steps to construct and place into operation a power plant of not less than fifty-four megawatts.

For a small city like Hastings, $70,000,000 is a very large expenditure indeed, but the city's analyses showed that in the long run this high initial capital investment would be offset by the anticipated fuel cost economies associated with the use of coal, as opposed to natural gas and oil, as a boiler fuel.

The City was not only concerned about the cost of its coal project to HU's customers. It was also very much aware of the national energy policy, which called for public utilities to decrease their dependence on oil or gas whenever and wherever possible.

D. The energy center plant

The $70,000,000 plan adopted by the City called for the construction of a coal-fired facility. The City decided to site the project on a two hundred seventy-seven acre tract two and one-half miles east of the City's corporate limits. The site is adjacent to an industrial park which at one time served as a Naval Ammunition Depot and was given the name "Energy Center."

Energy Center contains one coal-fired, steam electric generating unit consisting of a single boiler and turbine generator engineered to produce 70,000 kilowatts net generation, with maximum expected generation of 83,232 kilowatts.

The Energy Center was designed to receive coal by rail. Approximately 150,000 tons of coal must be received each year at the Energy Center in order for HU to meet the needs of its customers, and rail service is the only viable means of transporting such large volumes.

An annual coal requirement of the magnitude I described is indeed great, and when Hastings made its decision to use coal it was optimistic that it could obtain reliable and economical coal and coal transportation.

E. Obtaining coal and coal transportation

Once the decision to use coal was made in May of 1977, HU began to make inquiries with companies mining coal in the western coal fields. The purpose of these inquiries was to determine which mines could produce the type of low sulfur coal required by HU's boiler design, and which might be interested in providing HU with a steady source of coal. At the same time, preliminary rate inquiries were initiated with western rail carriers.

It was at this time that the City of Hastings learned that for all practical purposes there was no transportation competition between western coal carriers. Individual mines were served by only one carrier—thus precluding the ability to get a competitive price, nor did there appear to be any real price competition between carriers serving other mines—all rail prices were, in HU's view, quite high. Moreover, given the substantial rail tonnages involved, rail transportation was the only available means of transporting HU's volume coal requirements. Even so. HU was committed to coal and had the obligation to seek out the best possible arrangement, despite the unanticipated, high level of coal rates.

After evaluating its coal supply alternatives, and with a projected September 1, 1980 plant start-up slated, HU recommended to the Hastings City Council in March of 1980 that the City enter into a long-term supply contract to purchase coals from a Wyodak, Wyoming coal supplier. Under the terms of this contract, HU was required to purchase approximately 2,132,000 tons of coal over a ten year period, an amount which should satisfy all of its coal requirements.

In making its recommendations, HU was fully aware of the fact that both the Wyodak origin and the Energy Center destination were served by only one railroad—the Burlington Northern Railroad Company. At the time that HU was making the recommendations, the BN was quoting HU a rate of $13.25 per net ton for this movement.

HU thought this rate, along with other previous rate quotations it had received, was excessive, but despite HU's persistent efforts the BN would not alter its position as to the base rate of $13.25 and HU, even though unable to secure a fair rate from the BN, had little choice but to urge the City Council to enter into the Wyodak agreement and to meet its timetable for opening the Energy Center facilities.

Following HU's recommendations, the City Council voted on March 24, 1980 to approve the coal supply contract and authorized our Mayor to sign it, which he did on that date.

F. ICC litigation

HU began to ship coal to its Energy Center plant in October of 1980. Much to its shock and chagrin, however, the BN said that the effective rate for this traffic was not $13.25, but would be $16.03 per ton, as of January 1, 1981. BN said the increases were due to ICC approved "general rate increases," which I want to emphasize here the BN had never explained to HU and which HU was wholly unaware of. BN's unilateral actions were the last straw, and generated a strong public outcry that something must be done to stop the railroads avarice. What HU did is take its case to the ICC.

After a lengthy hearing, an ICC Administrative Law Judge issued a decision on January 19, 1982, holding that under the ICC's pre-1982 coal ratemaking standards the maximum rate on HU's coal traffic, as of January 1, 1981, should have been $12.40 per ton—a reduction of $3.63 per ton. Such a reduction would have saved Hastings' citizens millions of dollars. However, the Judge did not order any relief because he said that the ICC had said the Staggers Act required it to abandon all its past standards for judging whether coal rates were too high. Thereafter, the Judge took new evidence and issued a decision of July 2, 1982. In that decision, the Judge dismissed Hastings' complaint even though Hastings had demonstrated that the ALJ's initial decision was fully consistent with the principles of "stand alone" ratemaking—principles which the ICC later recognized as valid (though its version of the methodology was flawed). Thus, in the space of six months, a rate that was $3.62 too high suddenly became reasonable.

Quite frankly, after this second decision, Hastings became convinced that the ICC was out there only to protect the railroads and that without the ICC all HU could do was to negotiate a contract—which it did—with the BN. While this contract afforded some rate relief to Hastings it did not approach the $3.62 reduction that should have been required.

I have been informed that Hastings' litigation experience at the ICC is representative of recent captive coal ratemaking decisions. Based upon its misguided views of the Staggers Act, the ICC has consistently denied rail shippers relief that they are entitled to. Such wrongful actions should not be permitted to continue, particularly since it is the electric utility customers of Hastings and other cities that ultimately pay for the ICC's errant actions.

Hastings is a small city that the BN has sought to exploit. Under the Staggers Act, the ICC is supposed to protect shippers like Hastings from exploitation. Clearly, the ICC failed, and failed miserably in protecting Hastings. Congress simply cannot let this exploitation continue.

EXHIBIT A

The Western Coal Traffic League is a voluntary association of utility and industrial coal consumers whose members consume in excess of 25 million tons of coal per year. Because of the vital and continuing interest of its members in all matters pertaining to rail transportation of coal, WCTL has been an active participant in all major proceedings before the ICC affecting western coal transporation since its formation in 1976.

The Consumer Owner Power Coalition is a group consisting of the American Public Power Association, the National Rural Electric Cooperatives Association, four other power service organizations and eighteen individual consumer-owned utilities and joint action power agencies. COPC was formed for the express purpose of participating in the rulemaking proceedings initiated by the Interstate Commerce Commission in order to implement the Staggers Rail Act of 1980 and ensuing court litigation.

The American Public Power Association is a national service organization representing more than 1400-1750 local, publicly-owned electric utilities in 48 states, Puerto Rico, the Virgin Islands, American Samoa and Guam. Local publicly-owned utilities serve approximately 14 percent of all U.S. consumers.

The National Rural Electric Cooperatives Association is a national service organization whose membership consists of roughly 1,000 rural electric cooperatives. These member systems supply electricity to over 25 million people in 46 states.

EXHIBIT B.—DEFENDANTS' FIRST SET OF INTERROGATORIES

The defendant railroads named in this complaint submit the following interrogatories, pursuant to Rule 60 of the Commission's Rules of Practice, to be answered by complainant within 90 days after service of these interrogatores.

Definitions and instructions

I. "Affiliate" means any person (as defined herein) who, directly or indirectly, in whole or in part, owns or controls, is owned or controlled by, or is under common ownership or control with complainant.

II. "Document" means any writing or other compilation of information, whether handwritten, typewritten, printed, recorded, or produced or reproduced by any process, including but not limited to intra-company or other communications, business records, files, agreements, statements, pleadings, contracts, correspondence, letters, messages, telex messages, telegrams, memoranda, studies, directives, bulletins, tabulations, projections, summaries or records of telephone or personal conversations or interviews, reports, calendars, scrapbooks, journals, diaries, log books, notebooks, forecasts, photocopies, photographs, photographical negatives, maps, tape recordings, phonorecords, wire recording, computer tapes, computer programs, computer printouts, data processing cards, computer model, statistical or financial statements, accouts, data sheets, forms, graphs, charts, sketches, note charts, plans, drawings, tracings, blueprints, minutes or records or summaries of conferences, expressions or statements of policy, lists of persons attending meetings or conferences, opinions or reports or summaries of negotiations or investigations, brochures, newspapers, newsletters, magazines, periodicals, books, opinions or reports of consultants, pamphlets, advertisements, circulars, trade or other letters, press releases, comments, catalogues, drafts, revisions of drafts, invoices, vouches, receipts, orders, original or preliminary notes and any marginal notes or comments on any of the foregoing items. Further, the term "document" includes

(a) both basic records and summaries of such records (including computer runs);

(b) both original versions and copies that differ in any respect from original versions including all marginal notes or any original version or copy; and

(c) both documents in the possession of complainant and documents in the possession of consultants or others that have assisted complainant in connection with this proceeding.

III. "Identify," when used with respect to a document, means to:

(a) state the nature of the document (e.g., letter, memorandum, etc.);

(b) state the author, date, addressees, number of pages, and title of the document; and

(c) provide a brief but complete description of the content of the document.

"Identify," when used with respect to a person, means to state the person's full name, job title and business address.

IV. "Person" means any natural person, any business entity (whether partnership, association, cooperative, proprietorship or corporation), and any governmental entity, department, administration, agency, bureau or political subdivision thereof and every other type of organization or entity.

V. "Produce" means to make legible, complete, and exact copies of responsive documents which are to be sent via first class mail, to the undersigned attorneys. Any request to produce is informal and without prejudice to defendants' right to request an order requiring production of documents. In all cases where an interrogatory calls for a document to be identified or described, production of a true and legible copy of the document itself will be deemed a sufficient answer.

VI. "Product" or "commodity" means each product or commodity named in the complaint.

VII. "Rail routing" means the sequence of rail carriers and interline junctions used by the shipper for the transportation of the product or commodity from origin to destination, and includes the identification in such sequence of the origin, each rail carrier, each interline junction, and the destination.

VIII. "Referring to" a subject means making a statement about, discussing, describing, reflecting, dealing with, consisting of, constituting, comprising, or in any way concerning, in whole or in part, the subject.

IX. "Shipper" means any user of transportation, including but not limited to a consignor, a consignee, a producer and a receiver.

X. "Trade" means any reciprocal trading or swapping arrangement by which complainant or affiliate requests or directs a first shipper or receiver of a product or commodity to supply complainant or affiliate, or any other shipper or receiver designated by complainant or affiliate, with such product or commodity and, in turn, complainant or affiliate is requested or directed by such first shipper or receiver to supply it, or any other shipper or receiver designated by it, with like product or commodity.

XI. "Transportation" means the carriage of freight products or commodities by any carrier, whether regulated by the Interstate Commerce Commission or unregulated, for hire or private (including a carrier owned in whole or in part by complainant or any affiliate), by rail, motor, water, pipeline, or otherwise.

XII. References to railroads, shippers, or other companies (including complainant) include officers, directors, employees, consultants to, and agents thereof, except where the context clearly requires otherwise.

XIII. All uses of the conjunctive include the disjunctive and vice versa. Words in the singular include the plural and vice versa.

XIV. Specify the paragraph and subparagraph of these interrogatories in your answers thereto.

XV. In answering each of these interrogatories, complainant is to:

(a) Identify all source documents from which the information has been or can be obtained or which form a basis for the answers given or corroborate the answers given. For each source document identified state the name, title and address of the custodian of such document, and state whether such source document may be inspected and copied;

(b) State whether the information furnished is within the personal knowledge of the person answering and, if not, the name of each person to whom the information is a matter of personal knowledge;

(c) For each interrogatory (or part thereof), identify by name, address, position and responsibilities each person who assisted or participated in preparing or supplying any of the information given in answer to these interrogatories; and

(d) Verify the answers. Answers must be verified by the person or persons responding to specific interrogatories.

XVI. If exact data cannot be supplied in answering any interrogatory that calls for a numerical response, complainant should provide its best estimate of the data called for, indicate that it has done so by the notation "(est.)" in conjunction with the response, and describe the basis upon which the estimate was derived.

XVII. If complainant cannot answer any part of any interrogatory in full, after exercising due diligence to secure the information to do so, complainant should so state and answer to the extent possible, specifying its inability to answer the remainder, and stating whatever information or knowledge it has of each unanswered part.

XVIII. If complainant withholds the answer to any part of any interrogatory on the allegation that such answer is privileged or confidential, complainant should state the basis for such allegation and answer any remaining part of the interrogatory for which such allegation is not made.

XIX. If complainant withholds any document on the allegation that such document is privileged or confidential, complainant is to:

(a) identify the document; and

(b) state the basis for the allegation that the document is privileged or confidential.

XX. These interrogatories are continuing in character so as to require complainant to file supplementary answers if it obtains further or different information before final statements are filed, or, if a hearing should be held, before or during any such hearing. Where knowledge or information in the possession of complainant is requested, such requests include knowledge of its employees, agents, representatives, consultants, and attorneys.

XXI. Where interrogatories seek information as to the existence or content of any document, the furnishing of a true and legible copy of such document will be accepted as an adequate reply to the interrogatory.

XXII. Defendants specifically reserve the right to serve further interrogatories in this proceeding.

INTERROGATORIES

1. State each product or commodity, including the applicable Standard Transportation Commodity Code (STCC) number, which is the subject of the complaint.

2. For each product or commodity identified in your answer to interrogatory 1, state each fact which forms the basis for the allegation contained in the complaint that defendants possess market dominance over the transportation involved.

3. For each product or commodity identified in your answer to interrogatory 1, identify and state the full contents of each document including any marketing study or cost study prepared by or for complainant or any afffiliate referring to the allegation of market dominance contained in the complaint. You are informally requested to produce each document.

4. For each product or commodity identified in your answer to interrogatory 1, state the name of each rail carrier (including any rail carrier owned in whole or in part or operated by complainant or any affiliate) which provides or which could provide transportation (including via trackage rights or reciprocal switching rights) at any origin or destination named in the complaint, and state the name of each origin and destination.

5. For each product or commodity identified in your answer to interrogatory 1, state the name of each motor carrier, whether for-hire, common, contract, exempt or private (including any motor carrier owned in whole or in part or operated by complainant or any affiliate), which provides or which could provide transportation at any origin or destination named in the complaint, and state the name of each such origin or destination.

6. For each product or commodity identified in your answer to interrogatory 1, State the name of each water carrier, whether for-hire, common, contract, exempt, or private (including any water carrier owned in whole or in part or operated by complainant or any affiliate), which provides or which could provide transportation at any origin or destination named in the complaint, and state the name of each such origin or destination.

7. For each product or commodity identified in your answer to interrogatory 1, State the name of each pipeline, carrier, whether regulated or unregulated (including any pipeline carrier or pipeline owned in whole or in part or operated by complainant or any affiliate), which provides or which could provide transportation at any origin or destination named in the complaint, and state the name of each such origin or destination.

8. For each product or commodity identified in your answer to interrogatory 1, State the name of each carrier (including any carrier owned in whole or in part or operated by complainant or any affiliate), other than those carriers identified in your answers to interrogatories 4, 5, 6, and 7, which provides or which could provide transportation at any origin or destination named in the complaint, and state the name of each such origin or destination.

9. For each product or commodity identified in your answer to interrogatory 1, state each origin-destination pair which is involved in this complaint.

10. For each product or commodity identified in your answer to interrogatory 1 which was transported over each origin-destination pair identified in your answer to interrogatory 9, provide the following data for each of the calendar years 1974 through 1980, and for the twelve-month periods ending June 30, 1980 and June 30, 1981:

(a) total tonnage transported by all means of transportation;

(b) the amount of the tonnage identified in your answer to interrogatory 10(a) which was transported by each rail carrier owned in whole or in part or operated by complainant or any affiliate, and state the name and business address of each such carrier;

(c) the amount of the tonnage identified in your answer to interrogatory 10(a) which was transported by each rail carrier other than those carriers identified in your answer to interrogatory 10(b), and state the name of each such carrier;

(d) the amount of the tonnage identified in your answer to interrogatory 10(a) which was transported by each motor carrier owned in whole or in part or operated by complainant or any affiliate, and state the name and business address of each such carrier;

(e) the amount of the tonnage identified in your answer to interrogatory 10(a) which was transported by each motor carrier, whether common, contract, private, exempt or otherwise, other than those carriers identified in your answer to interrogatory 10(d), and state the name and business address of each such carrier and weather common, contract, private, exempt or otherwise;

(f) the amount of the tonnage identified in your answer to interrogatory 10(a) which was transported by each water carrier owned in whole or in part or operated by complainant or any affiliate, and state the name and business address of each such carrier;

(g) the amount of the tonnage identified in your answer to interrogatory 10(a) which was transported by each water carrier, whether common, contract, private, exempt, or otherwise, other than those carriers identified in your answer to interrogatory 10(f), and state the name and business address of each such carrier and whether common, contract, private, exempt or otherwise;

(h) the amount of the tonnage identified in your answer to interrogatory 10(a) which was transported by each pipeline owned in whole or in part or operated by complainant or any affiliate, and state the name and business address of each such carrier;

(i) the amount of the tonnage identified in your answer to interrogatory 10(a) which was transported by each pipeline carrier, whether regulated or unregulated, other than those carriers or pipelines identified in your answer to interrogatory 10(h), and state the name and business address of each such carrier;

(j) the amount of the tonnage identified in your answer to interrogatory 10(a) which was transported by each carrier owned in whole or in part or operated by complainant or any affiliate, other than those carriers identified in your answers to interrogatories 10 (b), (d), (f) and (h), and state the name and business address of each such carrier;

(k) the amount of the tonnage identified in your answer to interrogatory 10(a) which was transported by each carrier other than those carriers identified in your answers to interrogatories 10 (c), (e), (g), and (i), and state the name and business address of each carrier;

(1) the amount of tonnage identified in your answer to interrogatory 10(a) which was transported in any type of intermodal service regardless of the order or combination of modes or the nature or character of the carriers and state the order and combination of modes, the nature, character, name and business address of each carrier involved in the movements.

11. For each amount of tonnage identified in your answers to interrogatories 10(b) through (1) state:

(a) the dollar amount of charges incurred for the transportation of such tonnage for each carrier for each calendar year and twelve-month period requested in interrogatory 10;

(b) the rates on which the tonnage moves or the costs of such movements to you if in private carriage;

(c) the total revenue derived from the sale of the product or commodity or the total revenue derived from the products or commodities in which or in the production of which the products or commodities transported are used, whichever is applicable;

(d) the average or usual transit time for a shipment via each carrier utilized for each product or commodity; and

(e) whether special services (e.g., loading, unloading, tamping, securing, blocking, etc.) or special equipment were provided by each carrier providing the transportation service.

12. For each amount of tonnage identified in your answers to interrogatories 10 (b), (c), and (1) state the tonnage and the dollar amount of charges incurred for the transportation of such tonnage for each rail routing for each calendar year and twelve-month period requested in interrogatory 10.

13. State whether any of the rail transportation identified in your answers to interrogatories 10 (b), (c), and (1) is or was subject to a contract between complainant or any affiliate and any rail carrier (including any rail carrier owned in whole or in part or operated by complainant or any affiliate).

14. If your answer to interrogatory 13 is affirmative, state the name of each carrier involved in each such contract and the amount of tonnage transported under each contract for each product or commodity transported over each origin-destination pair for each of the calendar years and twelve-month periods requested in in-

terrogatory 10, the date and identifying number of the contract and the expiration date of the contract.

15. State whether any negotiations are underway, or contemplated by complainant or any affiliate, between complainant (or affiliate) and any rail carrier for the purpose of establishing a contract for all or any part of future transportation of the products or commodities identified in your answer to interrogatory 1 over any or all of the origin-destination pairs identified in your answer to interrogatory 9. If your answer is affirmative, identify:

(a) the name of each carrier involved;
(b) each product or commodity involved; including STCC number;
(c) each origin-destination pair involved; and
(d) the proposed duration of the contract.

16. State whether any of the non-rail transportation identified in your answers to interrogatories 10 (d) through (l) is or was subject to a contract between complainant or any affiliate and any carrier (including any carrier owned in whole or in part or operated by complainant or any affiliate).

17. If your answer to interrogatory 16 is affirmative, for each such contract, state:

(a) the mode of transportation involved;
(b) the name of each carrier involved;
(c) each origin-destination pair involved in the contract;
(d) each product or commodity involved in the contract, including STCC number;
(e) the period of time during which the contract has been or was in existence;
(f) the tonnage of each product or commodity identified in your answer to interrogatory 17(d) which has been transported under the contract over each origin-destination pair identified in your answer to interrogatory 17(c) for, as applicable, each of the calendar years 1974 through 1980, and for the twelve-month periods ending June 30, 1980 and June 30, 1981;
(g) the tonnage, on an annual basis or other applicable basis, which must be tendered by complainant or affiliate pursuant to the contract for each product or commodity identified in your answer to interrogatory 17(d);
(h) whether complainant or affiliate has tendered the required tonnage for each product or commodity identified in your answer to interrogatory 17(g) for each applicable period of the contract;
(i) the applicable per shipment minimum weight pursuant to the contract for each product or commodity identified in your answer to interrogatory 17(d);
(j) the actual average loading weight of the shipments moving pursuant to the contract for each product or commodity identified in your answer to interrogatory 17(d);
(k) whether the carrier provides any loading, unloading, or other operations or special services pursuant to the contract and, if so, identify the type of operations or special services so performed and any special equipment used for each product or commodity identified in your answer to interrogatory 17(d);
(l) the scheduled expiration or termination date of the contract;
(m) as applicable for each of the calendar years 1974 through 1980, and for the twelve-month periods ending June 30, 1980 and June 30, 1981, the rate per ton or other applicable measure paid for transportation pursuant to the contract for each product or commodity identified in your answer to interrogatory 17(d);
(n) the average and usual transit times under the contract, whether the contract contains any provisions specifying transit times and full description of those provisions, including any monetary incentives or penalties related thereto;
(o) the reasons why complainant or affiliate entered into the contract;
(p) the number or other reference by which complainant or affiliate identifies the written document which contains the terms and conditions of the contract.

18. You are informally requested to produce each document identified in your answer to interrogatory 17(p).

19. State whether any negotiations are underway, or contemplated by complainant or any affiliate, between complainant (or affiliate) and any non-rail carrier or combination of carriers for the purpose of establishing a contract for all or any part of future transportation of the products or commodities named in your complaint and identified in your answer to interrogatory number 1:

(a) over the origin-destination pairs identified in your answer to interrogatory 9 or;
(b) over any other origin or destination pair.

20. If your answer to interrogatory 19 is affirmative, identify for each such negotiation underway or contemplated each product or commodity involved (including STCC number), each origin-destination pair involved , and each mode of transportation involved.

21. State whether, during the period January 1, 1974 to the present, any carrier of any mode, whether common, contract, exempt, private or otherwsie, has solicited the transportation of any product or commodity named in the complaint and identified in your answer to interrogatory 1 from complainant or any affiliate for:

(a) each origin or destination involved in the complaint or identified in your answer to interrogatory 9; and

(b) any other origin or destination.

22. If your answer to interrogatory 21 (a) or (b) is affirmative, state for each such solicitation;

(a) the mode of transportation involved;

(b) the name and business address of each carrier involved;

(c) the amount of tonnage sought, by product or commodity (including STCC number), for each origin destination pair involved in the solicitation;

(d) the dates and means of the solicitaiton, whether by telephone, letter, personal visit, or other means;

(e) the full name, job title, and corporate affiliation of each person who solicited the tonnage;

(f) the rates quoted or rate estimates offered and the transportation services offered by each carrier identified in your answer to interrogatory 22(b) for each amount of tonnage identified in your answer to interrogatory 22(c);

(g) for each amount of tonnage identified in your answer to interrogatory 22(c), whether the carrier represented that it had adequate equipment to transport all of the tonnage involved in the solicitation and, if not, the portion of the tonnage for which it represented such equipment was available;

(h) whether any special services or speicial equipment would be provided and the nature of each, and

(i) the average or usual transit times and any provisions in connection therewith which were offered.

23. For each solicitation identified in your answer to interrogatory 22, state:

(a) complainant's or affiliate's response to the solicitation;

(b) the reasons for such response;

(c) whether complainant or affiliate used any transportation service of the soliciting carrier and, if so, indicate for which of the amounts of tonnage identified in your answer to interrogatory 22(c) each rate and service of the carrier was so used; and

(d) if complainant or affiliate decided not to use any service of such carrier, the reasons for that decision.

24. State wheter, during the period January 1, 1974 to the present, complainant or any affiliate has solicited the transportation service of any carrier of any mode, whether common, contract, exempt, private or otherwise, for the movement of any product or commodity named in the complaint and identified in your answer to interrogatory 1 or any origin or destination.

25. If your answer to interrogatory 24 is affirmative, state for each such solicitation:

(a) the mode of transportation involved;

(b) the name and business address of each carrier involved;

(c) the amount of tonnage offered by product or commodity (including STCC number) for each origin destination pair involved in the solicitation;

(d) the dates and means of the solicitation, whether by telephone, letter, personal visit, of other means;

(e) the full name, job title, and corporate affiliation of each person who solicitated the transportation service;

(f) the rates quoted or rate estimates offered and the transportation services offered by each carrier identified in your answer to interrogatory 25(b) for each amount of tonnage identified in your answer to interrogatory 25(c);

26. For each solicitation identified in your answer to interrogatory 25, state:

(a) whether complainant of affilitate used any transportation service of the carrier and, if so, indicate for which of the amounts of tonnage identified in your answer to interrogatory 25(c) each rate and service of the carrier was so used.

27. State whether complainant or any affiliate has ever supported any carrier application to the Interstate Commerce Commission or a State Commission for authority to provide transportation service from any origin or to any destination involved in this complaint.

28. If your answer to interrogatory 27 is affirmative, for each such application state:

(a) the name and business address of the carrier applicant;

(b) the docket number assigned by the Commission to the carrier's application;

(c) each product or commodity (including STCC number) which such carrier sought authority to transport;

(d) each origin-destination pair included in the carrier's application;

(e) whether the application was granted; and

(f) the reasons for complainant's or affiliate's support of the application.

29. For each product or commodity identified in your answer to interrogatory 1, state whether any destination involved in the complain has ever been supplied with such product or commodity from any origin other than those origins named in the complaint (including any origin outside the United States).

30. If your answer to interrogatory 29 is affirmative, for each of the calendar years 1974 through 1980, and for the twelve-month periods ending June 30, 1980 and June 30, 1981, state for each such destination:

(a) the amount of tonnage of each product or commodity which was so supplied from each origin other than those origins named in the complaint (including each origin outside the United States) and state the name of each such origin; and

(b) each mode of transportation and the name and business address of each carrier used to transport each amount of tonnage identified in your answer to interrogatory 30(a).

31. For each product or commodity identified in your answer to interrogatory 1, state whether it is possible that any destination named in the complaint could be supplied with such product or commodity from any origin other than those origins named in the complaint (including any origin outside the United States).

32. If your answer to interrogatory 31 is affirmative, state for each such destination:

(a) Each product or commodity which could be so supplied from each origin other than those origins named in the complain (including each origin outside the United States) and state the name of each such origin; and

(b) each mode of transportation and carrier which could be used to transport each product or commodity for each origin-destination pair identified in your answer to interrogatory 32(a).

33. For each product or commodity identified in your answer to interrogatory 1, state whether any origin named in this complain has ever supplied such product or commodity to any destination other than those destinations named in the complaint (including any destination outside the United States).

34. If your answer to interrogatory 33 is affirmative, for each of the calendar years 1974 through 1980, and for the twelve-month periods ending June 30, 1980 and June 30, 1981, state for each such origin:

(a) the amount of tonnage of each product or commodity which was so supplied to each destination other than those destinations named in the complaint (including each destination outside the United States) and state the name of each such destintion; and

(b) each mode of transportation and the name and business address of each carrier used to transport each amount of tonnage identified in your answer to interrogatory 34(a).

35. For each product or commodity identified in your answer to interrogatory 1, state whether any origin named in this complaint could supply such product or commodity to any destination other than those destinations named in the complaint (including any destination outside the United States).

36. If your answer to interrogatory 35 is affirmative, for each of the calendar years 1974 through 1980, and for the twelve-month period ending June 30, 1980 and June 30, 1981, state for each such origin:

(a) each product or commodity which could be supplied to each destination other than those destinations named in the complaint (including each destination outside the United States) and state the name of each such destination, and

(b) each made of transportation and carrier which could be used to transport each product or commodity for each origin-destination pair identified in your answer to interrogatory 36(a).

37. For each product or commodity identified in your answer to interrogatory 1, state whether during the next five (5) years complainant or any affiliate is or plans to increase its capacity to produce such product or commodity through the expansion of existing capacity construction or other addition or new capacity, acquisition of capacity from a producer other than complainant or affiliate, or by any other means, including but not limited to increasing capacity outside the United States.

38. If your answer to interrogatory 37 is affirmative, state for each such capacity increase:

(a) each product or comodity for which capacity will or could be increased:

(b) for each product or commodity identified in your answer to interrogatory 38 (a), the point or points of production or other specific geographic location or locations at which each such increase in capacity is taking place or is contemplated, including each point or location outside the United States;

(c) the annual amount in tons of each increase in capacity identified in your answer to interrogatory 38(b) and the year in which such increase in capacity is expected to or could beoome effective; and

(d) each mode of transportation which could be used to transport the increased production of each product or commodity from each of the points of production or other specific geographic locations identified in your answer to interrogatory 38(b) to each destination named in the complaint.

39. For each product or commodity identified in your answer to interrogatory 1, state whether complainant is or plans to decrease its capacity to produce or use such product or commodity at any origin or destination named in the complaint:

(a) regardless whether the rates involved in this complaint are reduced;

(b) only if the rates involved in this complaint are not reduced.

40. If your answer to interrogatory 39 is affirmative, state for each such capacity decrease:

(c) each product or commodity for which capacity will or could be decreased;

(b) for each product or commodity identified in your answer to interrogatory 40 (a), the origin and destination named in the complaint involved in such capacity decrease;

(c) the annual amount in tons of each decrease in capacity identified in your answer interrogatory 40(b) and the year in which such decrease in capacity is expected to or could become effective;

(d) whether the decreased tonnage will be supplied from another origin or used at another destination; and

(e) the identity, mode and regulated status of each carrier expected to carry:

(i) the remaining tonnage and in what amounts and

(ii) the divested tonnage and in what amounts.

If the specific carrier is undetermined, you may identify only the mode.

41. For each product or commodity identified in your answer to interrogatory 1, state whether complainant or any affiliate has ever made any trade of such product or commodity with another shipper.

42. If your answer to interrogatory 41 is affirmative, state for each such trade during each of the calendar years 1974 through 1980, and for the twelve-month periods ending June 30, 1980 and June 30, 1981:

(a) the name and business address of each shipper with whom complainant or affiliate has traded each produce or commodity identified in your answer to interrogatory 41.

(b) for each such trading shipper identified in your answer to interrogatory 42(a), identify each geographic location, including each location outside the United States, from which such shipper supplied complainant or affiliate (or another shipper designated by complainant or affiliate) with each such product or commodity, and the amount or tonnage so supplied by product or commodity and supplying shipper;

(c) for each such trading shipper identified in your answer to interrogatory 42(a), each georgaphic location, including each location outside the United States, at which such shipper supplied complainant or affiliate (or another shipper designated by complainiant or affiliate) with each such product or commodity, and the amount of tonnage so supplied by product or commodity and supplying shipper;

(d) for each such trading shipper identified in your answer to interrogatory 42(a), each geographic location, including each location outside the United States, from which complainant or affiliate supplied such shipper (or another shipper designated by such shipper) with each product or commodity, and the amount of tonnage so suppiled by product or commodity and receiving shipper; and

(e) for each such trading shipper identified in your answer to interrogatory 42 (a), each georgraphic location, including each location outside the United States, at which complainant or affiliate supplied such shipper (or another shipper designated by such shipper) with each product or commodity, and the amount of tonnage so suppiled by product or commodity and receiving shipper.

43. For each product or commodity identified in your answer to interrogatory 1, state:

(a) each purpose for which each such product or commodity is used at each destination named in this complaint; and

(b) the process by which the product of commodity is used in attaining that purpose.

44. State whether any product or commodity, other than those identified in your answer to interrogatory 1:

(a) has ever been used, in whole or in part, for any purpose for which the products or commodities indentified in your answer to interrogatory 1 are used on for any purpose identified in your answer to interrogatory 43, whether or not by the same process;

(b) the identity of that product or commodity; and

(c) the different process, if any, which was used.

45. If your answer to interrogatory 44 is affirmative, state for each, of the calendar years 1974 through 1980, and for the twelve-month periods ending June 30, 1980 and June 30, 1981:

(a) The name of each such substituted product or commodity, including STCC number, which was so used for each product or commodity named in the complaint and each origin (including each origin outside the United States) from which each such product or commodity was so supplied to each destination named in the compliant; and

(b) for each such substitute product or commodity for each origin-destination pair identified in your answer to interrogatory 45(a), the amount of tonnage transported by each mode of transportation and carrier used.

46. State whether any product or commodity, other than those identified in your answer to interrogatory 1, could be used, in whole or in part, for any purpose identified in your answer to interrogatory 43.

47. If your answer to interrogatory 46 is affirmative, state:

(a) the name of each such substitute product or commodity, including STCC number, which could be used for each product or commodity involved in the complaint and identified in your answer to interrogatory 1, and each origin (including each origin outside the United States) from which each such substitute product or commodity could be so supplied to each destination named in the complaint; and

(b) for each such substitute product or commodity for each origin-destination pair identified in your answer to interrogatory 47(a), each mode of transportation and carrier which could be used.

48. For each destination named in this complaint, state whether each product or commodity identified in your answer to interrogatory 1 is an input used in the production or manufacture of another product or commodity and, if so, state what product or commodity, including STCC number, is produced or manufactured with each input product or commodity so identified at each such destination.

49. For each product or commodity identified in your answer to interrogatory 1, state complainant's average annual price F.O.B. at each origin named in this complaint for each calendar years 1974 through 1980 and for the twelve-month periods ending June 30, 1980 and June 30, 1981.

51. For each product or commodity identified in your answer to interrogatory 1, state whether complainant or any affiliate has made any investment in non-rail equipment, including trucks, trailers, containers, or barges, or facilities related to the transportation of each such product or commodity.

52. If your answer to interrogatory 51 is affirmative, state for each such type of equipment purchased by complainant or affiliate;

(a) the number of units of non-rail equipment;

(b) the exact date or dates purchased (including month, day and year);

(c) the purchase price;

(d) the aggregate loading capacity of such equipment in net tons; and

(e) each product or commodity for which such equipment is being or could be used.

53. If your answer to interrogatory 51 is affirmative, state for each such type of equipment leased by complainant or affiliate:

(a) the number of units of non-rail equipment;

(b) the exact date or dates leased (including month, day and year);

(c) the name and address of each lessor;

(d) the term of each such lease;

(e) the aggregate loading capacity of such equipment in net tons; and

(f) each product or commodity for which such equipment is being or could be used.

54. If your response to interrogatory 51 is affirmative, state for each such facility owned by complainant or affiliate:

(a) the type and specific geographic location of each such facility;

(b) the date of construction or acquisition by complainant or affiliate;

(c) the cost to complainant or affiliate of construction or acquisition;

(d) the current depreciated book value of the facility;

(e) at the time the facility was completed and for each calendar year from 1974 through 1981, the products produced or used at and handled over the facility and the mode of transporting them to the facility; and

(f) the annual handling, processing, or other through-put capacity in net tons for each product or commodity for which such facility is being or could be used.

55. If your answer to interrogatory 51 is affirmative, state for each such facility leased by complainant or affiliate:

(a) the type and specific geographic location of each such facility;

(b) the exact date leased (including month, day and year);

(c) the name and business address of the lessor;

(d) the term of such lease;

(e) the annual handling, processing, or through-put capacity in net tons for each product or commodity for which such facility is being or could be used;

(f) the current depreciated book value of the facility;

(g) the current depreciated book value of the lease; and

(h) the products or commodities produced or used at and handled over the facility and the mode or transporting them to the facility at the time the facility was leased and for each calendar year from 1974 through 1981.

56. Identify all persons that will testify on your behalf. If any person testifying for you will present expert testimony:

(a) identify him,

(b) his area of expertise, and

(c) identify all exhibits which your witnesses or you will either rely on or offer into evidence.

57. For each product or commodity identified in your answer to interrogatory 1 for which complainant alleges it is tied to a particular source of supply by a supply contract, state for each such contract:

(a) the business name and address of each party to the contract;

(b) the effective date of the contract;

(c) the term of the contract;

(d) whether the contract includes any option for renewal or renegotiation by any party to the contract and, if so, state:

(i) the effective date or dates of such options (ii) which party or parties has the right under the contract to exercise such options, (iii) each contract-specified circumstance under which each party may exercise such options, and (iv) the term of the renewed or renegotiated contract if each such option is exercised;

(e) the minimum amount of the product or commodity which complainant is required to purchase under the contract, and the contract-specified timing of each such purchase;

(f) whether the contract specifies the geographic location from which complainant must obtain the product or commodity;

(g) whether complainant has the right under the contract to resell the product or commodity and, if so, state: (i) the maximum amount which can be resold, and (ii) each contract-specified arrangement for the transportation of the product or commodity resold to the purchaser;

(h) whether complainant has the right under the contract to assign its rights under the contract to a third party and, if so, state each contract specified circumstance under which complainant may exercise such right of assignment; and

(i) whether complainant has the right under the contract to terminate the contract prior to the expiration of the term identified in your answer to interrogatory 57(c) and, if so, state: (i) each contract-specified circumstance under which complainant may exercise such right of termination, and (ii) the resulting new term of the contract for each such circumstance.

58. Produce each contract (including each amendment thereto) identified in your answer to interrogatory 57.

59. For each product or commodity identified in your answer to interrogatory 1 for which complainant alleges it has made substantial investment in rail-related equipment, state for each such type of equipment purchased:

(a) the number of units of rail equipment;

(b) the exact date or dates purchased (including month, day and year);

(c) the purchase price;

(d) the depreciated value of such equipment at the date the complaint was filed with the Interstate Commerce Commission;

(e) the dollar amount of investment tax credits taken by complainant or any affiliate as a consequence of such purchase;

(f) as applicable, the aggregate loading capacity of such equipment in net tons or motive power of such equipment; and

(g) each product or commodity for which such equipment is being or could be used.

60. For each product or commodity identified in your answer to interrogatory 1 for which complainant alleges it has made substantial investment in rail-related equipment, state for each such type of equipment leased:

(a) the number of such units of rail equipment;

(b) the exact date or dates leased (including month, day and year);

(c) the name and business address of each lessor;

(d) the term of each such lease;

(e) the schedule of payments required by each lease, including (i) the initial payment at the effective date of the lease and (ii) the annual payments to be made and the years in which such payments are to be made;

(f) the dollar amount of investment tax credits taken by complainant or any affiliate as a consequence of each such lease;

(g) whether each such lease may be assigned or terminated prior to the expiration of the term identified in your answer to interrogatory 60(d);

(h) as applicable, the aggregate loading capacity of such equipment in net tons or motive power of such equipment; and

(i) each product or commodity for which such equipment is being or could be used.

61. For each product or commodity identified in your answer to interrogratory 1 for which complainant alleges it has made substantial investment in rail-related facilities, state for each such facility owned:

(a) the type and specific geographic location of each such facility;

(b) the date of construction or acquisition by complainant;

(c) the cost to complainant of construction or acquisition;

(d) the depreciated value of the facility at the date the complaint was filed with the Interstate Commerce Commission;

(e) the dollar amount of investment tax credits taken by complainant or any affiliate as a consequence of such construction or acquisition of the facility;

(f) the annual handling, processing, or other through-put capacity in net tons for each product or commodity for which such facility is being or could be used;

(g) whether the facility can also be used to handle products or commodities transported by other modes;

(h) whether the facility can be adapted to handle products or commodities transported by other modes and at what cost; and

(i) the products or commodities produced or used at and handled over or at the facility and the mode of transporting them to the facility at the time the facility was built and for each calendar year from 1974 through 1981.

62. For each product or commodity identified in your answer to interrogatory 1 for which complainant alleges it has made substantial investment in rail-related facilities, state for each such facility leased:

(a) the type and specific geographic location of each such facility;

(b) the exact date leased (including month, day and year);

(c) the name and business address of the lessor;

(d) the term of such lease;

(e) the schedule of payments required for each such lease, including (i) the initial payment made at the effective date of the lease and (ii) the annual payments to be made and the year in which such payments are to be made;

(f) the dollar amount of investment tax credits taken by complainant or any affiliate as a consequence of each such lease;

(g) whether each such lease may be assigned or terminated prior to the expiration of the term identified in your answer to interrogatory 62(d);

(h) the annual handling, processing, or other through-put capacity in net tone for each product or commodity for which such facility is being or could be used;

(i) whether the facility can also be used to handle products or commodities transported by other modes;

(j) whether the facility can be adapted to handled products or commodities transported by other modes and at what cost; and

(k) the products or commodities produced or used at and handled over or at the facility and the mode of transporting them to the facility at the time the facility was built and for each calendar year from 1974 through 1981.

63. For the period 1972 to date, state whether complainant or any affilate or any officers, employees, consultants, agents or attorneys of either or any person connected to any trade organization of which complainant is a member have repesented to the Interstate Commerce Commission in any proceeding that the traffic involved in this complaint and identified in interrogatory number 1 is susceptible to diversion from rail to any other mode or that the traffic had been or would be diverted in

whole or in part if rate increases or other changes in rates or services by rail carriers were permitted or ordered by the Commission, identify the documents in which such representations were made and state the contents of such representations.

64. State whether the rates for any commodity for any origin or destination involved in this complaint, as identified in interrogatories 1 and 9 or otherwise, were initiated, suggested or negotiated by complainant or any affiliate or its consignors, consignees, suppliers, receivers or predecessors in interest of any of them.

65. Identify all documents relating to such initiated, suggested or negotiated rates in your answer to interrogatory 64 and state the contents thereof.

66. State whether and by what amounts the rates referred to in interrogatory 63 have been increased other than by general rate increases authorized by the Interstate Commerce Commission since their initiation suggestion or negotiation.

67. Have you ever used any carrier or combination of carriers, whether rail, motor, water, pipeline or otherwise (whether common, contract, private, exempt or otherwise) to transport the commodities named in your complaint and listed in your answers to interrogatory number 1 between any origin-destination pair not listed in your answer to interrogatory number 9.

68. If your answer to interrogatory number 67, is affirmative, identify:

(a) the origin-destination pairs referred to;

(b) the name, business address and mode of carriers providing the transportation service between those origin-destination pairs;

(c) the time periods or years during which the transportation took place; and

(d) whether special equipment or special services (e.g., loading, unloading tamping securing, blocking, etc.) were provided.

69. Have you ever considered or investigated the use of any non-rail carrier or combination of carriers, whether motor, water, pipeline or otherwise and whether common, contract, private, exempt or otherwise, and whether owned by or affiliated with your company or not, to transport the commodities named in your complaint and listed in your answer to interrogatory number 1 between any origin-destination pairs listed in your answer to interrogatory number 9? Do not include carriers which you solicited for transportation service which are included in your answer to interrogatories 24, 25 and 26.

70. If your answer to interrogatory number 69 is affirmative, identify:

(a) the name, business, address, mode and character of the carriers investigated;

(b) the commodites and origin-destination paid points involved in the investigation;

(c) the nature and costs of the services investigated for each commodity and origin-destination pairs point named in interrogatory 70(b);

(d) the time period or year of the consideration or investigation; and

(e) the existence, nature and full contents of any documents relating to such consideration or investigation.

71. Which carriers or combination of carriers of any non-rail mode and of any character, to the best of your knowledge, have operating authority or otherwise hold themselves out to transport the commodities named in your complaint and identified in your answer to interrogatory number 1 between the origin-destination pairs points named in your answer to interrogatory number 9 including but not limited to carriers whose services you use?

72. For any carrier named in your answer to interrogatory number 71, give the ICC authority and tariff authority to the extent applicable or available.

73. To the extent tariff authority or other rate quotations are available, give the current rates for any carrier named in your answer to interrogatory number 71 for the commodities and origin-destination pair points referred to therein.

74. Have you, the complainant, or any affiliate, or any officer, employee, agent, consultant, or attorney of the complainant or person connected with complainant, including a trade organization or other shipper group ever made a statement, either orally or in writing or both before any railroad or motor carrier rate bureau or water carrier conference concerning the rates on the commodities named in your complaint and identified in your answer to interrogatory number 1?

75. If the answer to interrogatory number 75 is affirmative, state for each such statement:

(a) the bureau or conference before which the statement was made;

(b) the date of the statement;

(c) the submittal or docket number if any;

(d) the identity and position of the person making the statement;

(e) the identity of any document used or submitted in connection with the statement and the contracts thereof;

(f) whether the statement included any competative or other circumstances that would have necessitated or suggested a rate reduction and what those circumstances were; and

(g) the competitive and other circumstances included in each statement.

76. You are informally requested to produce your most recent annual report to your shareholders and most recent 10K report to the Securities and Exchange Commission.

77. State Complainant's full corporate name.

(a) State Complainant's State of incorporation.

(b) State if Complainant is part of a conglomerate or is affiliated with a subsidiary of, or parent of, another corporation or business entity or a division or subdivision.

(c) If the answer to "b" above is affirmative, identify the conglomerate, all affiliates, divisions, subdivisions, or other business entities and identify the State of incorporation of each.

78. State Complainant's principal place of business.

79. State Complainant's principal business or businesses.

(a) If Complainant is affiliated with other corporations, business entities, or a division or subdivision, state the principal business of each.

(b) State the principal place of business of each affiliated corporation, other business entity, division or subdivision.

Senator DANFORTH. Senator Exon.

Senator EXON. Thank you, Mr. Chairman.

I have listened with interest to Mr. Doyle and Mr. Whelan, obviously both of Irish descent and proud of it. We should all notice that the Irish have a tendency to always understate their case, and it has been well stated here this morning.

I take it, Mr. Doyle, that in your statements about Burlington Northern and how they figure their profits and project them maybe you were saying that figures do not lie, but sometimes railroads do not figure right. Is that a fair characterization of what you were saying?

Mr. DOYLE. Let me say that to my knowledge the railroad method of accounting, prior to this year, has been absolutely unique. For example, you will find that in the 1982 annual report of the Burlington Northern at page 25 there is a footnote, and it says "Charges to ways and structures include $336,743,000 * * * for 1982, * * * for repairs, and renewals of track structure under the "retirement-replacement-betterment" method of accounting as described in accounting policies."

What that says is this. In the year 1982 the Burlington Northern charged and expensed $366 million of investment they put into their track. If you take a look at their operating income from their railroad, it shows $245 million. If you add the $366 to the $245, you are at $612 million.

Now, that is the operating income from the railroad ($600 million) and not something about 40 percent of that amount ($245 million) which should go into the computation of the so-called return.

Senator EXON. Mr. Whelan, let me ask you a question or two.

I am familiar with the disaster that hit Hastings, Nebr. I was very aware of it at the time. I am still very much aware of it. And I am glad that you brought out the facts and figures that you did.

I guess your testimony this morning would indicate that contracting with at least Burlington Northern is pretty much of a one-sided and one-way street?

Mr. WHELAN. Well, I do not know that it is Burlington Northern. I would sit down and negotiate with their lawyers—they are good lawyers—I will sit with them, but there is no mutuality when you know the predisposition of the Commission, Senator. You know, we do not have any trumps left. They took our cards. We do not have any place to go, so we cannot negotiate when you know that they have got some place to go, and you do not.

So I sat at that negotiating table knowing what the predisposition was. I never really understood it as well until this morning when I sat up here and I heard the chairman and the other Commissioners say that they were committed philosophically to deregulation, even for captive customers. We will try to work that out for those poor devils.

And I fully understood then and now why I was so helpless in negotiations, because without mutuality you cannot negotiate.

Senator EXON. One of the problems with working in the District of Columbia is that we fail to realize what is going on out there.

What is your perception, Mr. Whelan, of the credibility in the minds of the average person, at least in Hastings, Nebr., as to how well they are presently being represented by the ICC with the experience that you had in Hastings, Neb., and still have?

Mr. WHELAN. Well, if we had not plugged that hole with quick action to try to get a contract out of those folks—you see, they hit a high water mark, then they contract with you, and that was the game that we got caught in, and that is why the ICC is reporting so many contracts because once you get it up to the high water contract, we got stuck.

Now, I hope inflation takes care of us because we had to have the coal. We already built our powerplant. We had already signed an 8-year contract, a 10-year contract, essentially, for coal. So to get the ground cut out from under us by the ICC where we thought we could have a shot at reasonable costs, and all they are talking about is revenue inadequacy, almost to the exclusion of these other things. I am not fighting with them about revenue inadequacy. That is a legitimate thing.

But to hear these good people from the Commission, it has really been driven home to me that it is almost to the exclusion of every other thing that you good people built in the law. And I agree with what Senator Long said, that here you folks have fought hard and long over these amendments to draft a law, and they have got tunnel vision. They look at revenue inadequacy, and that is it. They do not look at rolled-in costs. And the stand alone theory, you know what that means? That means that they can charge as much up to a point where the city of Hastings could buy a bunch of dump trucks and go out to Wyoming and get their coal. That is really what it amounts to.

That is not a fair standard. That does not make sense. It is wasteful.

Senator EXON. Mr. Chairman, my time is up.

I just want to thank you gentlemen for coming here this morning with your testimony. I think it puts it in perspective for some of us who have been very much concerned about the way the ICC has handled the language that we wrote into the bill, which I think indicates we are going to have to do something about it.

As I said earlier, we all should remember that what the Congress giveth, the Congress can taketh away. And it seems to me in this case we may have to do something in that area unless we can get the ICC under the pressure from the White House to change its attitudes.

Senator **Danforth**. Senator Long.

Senator **Long**. Mr. Doyle, utilities are pretty big businesses.

Can the utility build its own railroad?

Mr. **Doyle**. Well, as a practical matter, no. In many parts of the country, of course, there is not the space to do it. I think you will find as a practical matter the answer has got to be no. We do not have the power of eminent domain. We would have to come to the Congress for that. As a practical matter, no.

Senator **Long**. Well, even if you did, would it really make any sense that they should even consider making you pay a rate that would include the cost of building your own railroad and hauling just to serve your own company when if you had a railroad, it ought to be serving all of the people in the area and distributing the cost over the whole gamut of customers rather than just putting it on one customer.

Now, do utilities feel that they could shift to other fuels very easily?

Mr. **Doyle**. Let me make that point clear. First of all, we are prohibited by this Congress from shifting to natural gas under the Fuel Use Act.

Second, under the environmental requirements, we are prohibited from using in some of our units that are later models here, coal with sulfur content of higher than 0.6 percent in order to meet the primary air quality standards.

Yes, I suppose you could, with millions of dollars of expenditures, redo your boilers, your coal boilers to accommodate oil fired. You might suffer a capacity loss, and then you might go and buy OPEC oil. But that would require a major shift in the entire fuel policy and energy policy of the United States.

These would produce huge increases for our customers that are completely unconscionable.

Senator **Long**. Do the people in your industry have an alternative maximum rate standard that you could suggest?

Mr. **Doyle**. Well, we have advocated consistently to the ICC that the standards set forth in the statute are the ones it should be looking at. That is, that traffic carried below its marginal cost should be eliminated; that competitive traffic be required to bear as much of the railroad's fixed costs as possible, and that the captive coal traffic be required to bear it fully distributable costs plus an equitable portion of the railroad's unavoidable revenue shortfall that remains—that is that portion which they cannot shuck off by the other two means.

We took this position before the Commission, but the Commission has not heard us on it. We have indicated what is happening with Long-Cannon. Yes, we have consistently I think, indicated to the Commission that the standard ought to be the standard of fully allocated costs plus a fair share, if you will, of the unavoidable shortfall in revenue in order to keep the railroad company solvent and providing the service.

Senator **Long**. Now, your industry does not object to the railroads making a fair return on investment, do you?

Mr. **Doyle**. Absolutely not, Senator.

Senator **Long**. But you do know enough about regulation and about what is fair to charge a customer. You have had to justify your rates often enough where you find yourself in the position of being a captive customer, and you have in mind the kind of requirement that is placed on you to justify a rate increase. In fairness, is it not logical that the railroads ought to have to meet some of the same tests that you have to meet when you try to seek an increase in rates to the customer?

Mr. **Doyle**. We would think so, and when we go before our commissions, we have the burden of proof, not our customers, to prove that we are operating and managing the business efficiently. We can only recover through that rate regulation the actual reasonable expenses incurred plus, a return measured by, if you will, something less than the current cost of capital on only that portion of our total capital which is the common equity as put into the business by the common stockholders.

Now, that is a completely different test than the revenue adequancy ones the railroads are talking about by which they drive down the apparent "return" that they are earning and using figures that are probably less than a third of——

Senator **Long**. Could I ask one additional question, Mr. Chairman?

Would it not seem fair that when you represent millions of people, and those people are being victimized, in your judgment, by very high rates—and the good Lord knows you ought to know something about what the reasonableness of the rates is because you study the whole issue with good staff and lawyers and experts from every line of endeavor—would it not seem fair that if you want to challenge the fairness of that rate, that the burden ought to be on the other guy to justify it, that he ought to have to bring his books forward and present his records just like you have to do when you go in seeking a rate increase?

Mr. **Doyle**. That has been my experience over the past 35 years in this industry. I have never seen the burden shifted to the customer.

Senator **Long**. Now, we are not talking here about a situation where there is hot competition. We are talking about a situation where there is no competition. You are at the mercy of these people.

Mr. **Doyle**. That is right, we are captive all the way.

Senator **Long**. Now, what sense does it make to say that their books would not be open to you or that they should not have to justify that rate?

Mr. **Doyle**. I do not understand it.

Senator **Long**. Was that not what we had in mind when we offered that amendment—and I was a sponsor of that amendment, was being opposed by the railroads, and was seeking the advice of your industry at the time—on behalf of my customers and on behalf of your industry, to protect my customers?

Mr. **Doyle**. That is the way we read the legislative history.

Senator **Long**. That is what the whole issue was all about. And to come in now and say I am sorry, but only under certain circumstances will we permit discovery—my thought is why should discovery be necessary. Make those people justify it to begin with.

Mr. **Doyle**. I would agree.

Senator **Long**. And then see where we go from there. And maybe you might need some discovery, but so far it has been your experience that the Commission has relieved the carriers of the burden of justifying a rate on captive coal.

Is it your impression that the way it stands right now the Commission has in effect relieved railroads of the burden of justifying their charge on captive coal?

Mr. **Doyle**. Yes; in the case of. Kansas City Power & Light Co. in western Missouri, the Commission's order or decision in effect said, all right, so the ratios of your revenue to your variable cost is 215 percent, or up to that. We have approved as reasonable even higher ratios than that so long as the railroad is revenue deficient and everybody knows the BN railroad is revenue deficient. So the case is dismissed, and get out. And that decision has cost the customers in my system $2 million a year, and that $2 million is going to be every year for the next 20 years or more. That is my Missouri and Kansas customers.

Senator **Long**. Thank you.

Senator **Danforth**. Senator Pressler.

Senator **Pressler**. Mr. Doyle, the railroads said, as I understand it, that the ICC's determination of revenue adequate is no different than what is used for other regulated industries, and that their consideration of current cost of capital is quite typical. And as I understand it, your testimony is to the contrary.

Could you elaborate on your position?

Mr. **Doyle**. Absolutely. In the electric utility industry and under generally accepted accounting practices, so far as I know, what we are looking at here and what the financial community is looking at is what is the current cost, if you will, of the common equity capital that is invested. That is where and how the fair return ought to be measured because the utilities and all businesses and industries are competing for the investor's dollar.

The trouble here is that the ICC revenue adequacy test is not just a number. If you take, for example, 14 percent, let's assume that is the railroad's current cost of equity capital. First of all, they apply that rate to all total capital when, in fact, as an industry, 40 percent of the total capital of the railroads is in debt and in preferred, and I understand the embedded cost of the debt component is something about 7.8 percent.

Now, then, if you start measuring their earnings on common equity capital by applying 14 percent on total capital, but only use half of that rate for debt, look what happens to the common equity return portion. It jumps up to about 18 or 20 percent immediately once you do that calculation.

Second, as I indicated before, up until this year, they have been expensing betterments that we would treat as capital expenditures, and would be required to do so and must do so.

What is the effect of that? They are artificially reducing the net operating income. So they are reducing the dollars you put into the numerator to lower the percentage return.

Third, they are increasing the denominator by deferred taxes as capital the stockholders never provided. The shippers provided the deferred taxes. The public provided it through deferred taxes.

Adding that to the capital as part of the net investment to increase the denominator and reduce the rate of return.

So as a result of reducing the numerator, increasing the denominator, and failing to apply their embedded costs of debt and preferred, they are understating the rate of return earned. In my opinion, when they speak of a 3-percent return, I think that translates into something on the order of 14, 15, or 16 percent return on the common equity supplied by the common stockholders, as would be applied in all of industry that I know under generally accepted accounting practices.

Senator **Danforth**. Thank you.

Mr. Doyle, you are from Kansas City?

Mr. **Doyle**. Yes, sir. I am president and chairman of the board of Kansas City Power & Light Co.

Senator **Danforth**. Do you think that the railroads are better or worse than Billy Martin?

Mr. **Doyle**. I will answer that by saying this, Senator. We are importing from the Powder River Basin over 5 million tons of coal a year, and that is at the rate of about 14,000 tons a day. If that had to come by truck in 20-ton trucks, that is, as I do the arithmetic, something like 700 trucks. But it takes a truck 5 days to come up and around. That is 3,500 trucks. My alternative: 3,500 trucks running up and down from Kansas City to the Powder River Basin every day, 365 days of the year. That is not a very good alternative.

And as far as contracts, how do you sit at the bargaining table with a monopolist? He has got all the cards. He has got the service and the ability. What have you got to trade with?

The ICC is no help to us. The modus operandi I think of the railroads in the last few years has been go out and grab off these long-term coal contracts right now. The Burlington Northern is demanding take-or-pay provisions from me, Senator. This will be of interest to you. Last Friday they were in our office, they want a 20-year long-term coal transportation contract with take-or-pay provisions. They will give us no provisions for productivity changes in the escalation formual, and they want to apply the escalator to 100 percent of the total rate, not just the portion which is variable.

Mr. **Whelan**. That is what we signed, Mr. Doyle; 100 percent. We signed it.

Senator **Danforth**. Thank you very much.

Mr. **Doyle**. Mr. Ziemer, president and CEO of Wisconsin Public Service Corp., has one statement.

Mr. **Ziemer**. I am Paul Ziemer, president of Wisconsin Public Service Corp. in Green Bay, and I do not want to prolong the hearing, but we had the same experience with the Burlington Northern that Mr. Doyle has. We were required to meet the air quality standards to use low sulfur coal, and it has to come from the Powder River Basin. The only shipper is the Burlington Northern, and they have no competition. And as the other gentleman said, they are holding all the cards. That is our problem.

Our cost of coal at our new plant completed in 1981 is $37 a ton, $23 of which is freight.

Senator **Danforth**. Gentlemen, thank you very much.

The next panel, a panel of coal producers, Mr. S. O. Ogden, Mr. Alan Walker, and Mr. James Scahill.

Mr. Bagge, I understand you would like to introduce Mr. Ogden.

STATEMENTS OF S. O. OGDEN, PRESIDENT, SUNEDCO COAL CO., ON BEHALF OF NATIONAL COAL ASSOCIATION, ACCOMPANIED BY CARL E. BAGGE, PRESIDENT, AND JOEL LEMA, VICE PRESIDENT OF TRANSPORTATION, NATIONAL COAL ASSOCIATION; ALAN WALKER, PRESIDENT, BRADFORD COAL CO.; AND JAMES SCAHILL, EXECUTIVE VICE PRESIDENT, PENNSYLVANIA COAL MINING ASSOCIATION

Mr. BAGGE. Mr. Chairman, my name is Carl Bagge. I am president of the National Coal Association.

I just want to make two observations and then introduce the chairman of the Transportation Committee, Mr. Bud Ogden.

I appeared on behalf of the Nation's coal industry before this very committee on November 19 of 1981. The statement I have before me here I would like to reintroduce into the record because all of the things that we talked about, that we feared as coal producers, have come to pass. All of the elements, all of the concerns that we expressed to this committee have indeed come to pass in spades, far worse than what we articulated in that statement on November 10, 1981

Second, I would like to confess error, admit error here before the members of this subcommittee. The National Coal Association, speaking for the Nation's coal producers, supported the Staggers Rail Act because we wanted a viable railroad industry. I am here to say that we reject that position now and we are here to confess error because we think in retrospect the ICC has not implemented the carefully crafted compromise that led to the support of the coal industry for the enactment of the Staggers Act.

And with that, I would like to introduce, since I was obviously not persuasive enough here last, in 1981, I have called upon someone from the real world, Mr. Bud Ogden, the president and CEO of Sunedco who is the coal digger for the famous San Antonio rate case. He is the fellow who reduced the rates for the citizens of San Antonio in that very famous and historic case which should have given rise to some legislation, it seems to me, in 1981, who also serves as the chairman of the NCA Transportation Committee.

With that, I would like to conclude my remarks.

Mr. OGDEN. Thank you, Carl.

First, let me just say we also have Joel Lema, vice president of transportation for the NCA with us here today as well.

Second, I would like to profoundly endorse and support everything you just heard from the utility industry representatives and urge you to give serious consideration to those rather tragic events that they described.

I would like also to thank you, Mr. Chairman, and the National Coal Association commends you for holding hearings on the 1980 Staggers Rail Act. As Carl just pointed out, NCA supported the Staggers Act as signed into law in October 1980. Our support was predicate on a notion that the regulatory process administered by the Interstate Commerce Commission would conform with the captive shipper protection provisions of the 1980 act, and the intent of Congress in continuing protection against abuses in rail rates and services to which captive coal shippers are vulnerable due to the absence of transportation competition.

Unfortunately, the Commission has utterly failed to be responsive to the captive shipper protection required under the 1980 act. The Commission has failed, and I quote, "to provide a regulatory process that balances the needs of carriers, shippers and the public." That is quoted from section 3 of the Public Law 96-488, the Staggers Rail Act of 1980. Let me repeat that quote, please. "To provide a regulatory process that balances the needs of the carriers, shippers, and the public."

This failure is underscored by the Commission's unwillingness to fulfill the policy mandated in section 101.01(a), subtitle 4, title 49 of the United States Code, and that, I quote, "In regulating the railroad industry, it is the policy of the U.S. Government to maintain reasonable rates where there is an absence of effective competition." Now, that is the policy of the U.S. Government, not the Interstate Commerce Commission.

In the last 4 years, rail rates for carrying coal have increased 1½ times the increase in the Bureau of Labor Statistics Producer Price Index, whereas mine prices of coal have increased only half as much as the increase in the IPP.

Now, we are not going to go back four or five decades like some folks have, but I would like to point out on Exhibit A here what that looks like. There is 1979 through 1983, actual data, actual costs. The black bars are the cost of coal FOB the mines. The crosshatched area is what the producer price index for all commodities in the same period is. That is the relevant period, in our judgment, and that is what the data show.

This is a 3 to 1 relationship in the two components of delivered price of coal.

Exhibit 2 shows the same graph now, and we have simply added the cost, rail cost of delivering coal. That is the actual coal rate applied to the coal that was shipped in a like period. It has gone up 1½ times as much as the commodities index and three times what has happened to the price of coal.

Let me just comment on something that you saw earlier relative to railroad rates and coal prices. The time period was picked, I think, rather carefully in that presentation in that our industry complied with your mandates to implement improved mine health and safety and environmental protection in all of our mining operations, and that drove up costs, obviously, that had to be incorporated in price, and that distorts, I think, the data that you were shown earlier.

Our concerns are magnified and underscored by three recent decisions of the Commission. First, the possibility that different sources or substitute commodities would be a determining factor as to the existence of market dominance for coal shipments which have no effective transportation alternative to railroad movement, serious concern. Second, that a standard for increases in coal rates that is 15 percent above the annual inflation rate, would be allowed.

I have a graph here. What we have simply done is taken this proposed ICC coal rate guideline—and we heard a lot today about trust us, it is just proposed, do not worry about it. If we just assume a simple 5 percent inflation rate, add to that this 15 percent that the Commission would propose to allow in addition thereto, you see that in less than 10 years, a 452 percent increase in the cost of the railroad transportation.

Our third concern is that railroad movements of export coal, which as you heard earlier, is a classic example of railroad market dominance, that they would be exempt from regulation, and this traffic would become fully deregulated.

Pending legislation, S. 1082 and H.R. 2584 should be promptly enacted to deal with these very serious problems. The decision to consider product and geographic competition, instead of railroad competition, for moving the same commodity from the same origin to the same destination as a basis for determining market dominance destroys the captive shipper protection that was critical to the NCA agreement to support the Staggers Act to begin with. That has to be restored.

[The statement follows:]

STATEMENT OF S. O. OGDEN, PRESIDENT, SUNEDCO COAL CO.

Mr. Chairman, my name is S. O. Ogden. I am president of Sunedco Coal Company. I am appearing before you today on behalf of the National Coal Association. NCA represents coal producers, coal sellers, and other organizations associated with America's coal industry. I am a member of NCA's board of directors and serve as chairman of NCA's Transportation Committee.

We commend you, M. Chairman, for holding hearings on the 1980 Staggers Rail Act. NCA supported the Act as signed into law in October of 1980. However, our support obviously was predicated on a notion that the regulatory process administered by the Interstate Commerce Commission would comply with the provisions of the 1980 Act and would conform with the intent of the Congress as expressed in the legislative history leading toward passage of the legislation.

Unfortunately, the Commission has failed to do so in several instances following enactment of the legislation. We are surprised and shaken by the Commission's failure, and now believe that Congress must furnish legislative guidance to the Commission in order to assure that the 1980 Act is implemented as intended. Therefore, the coal industry, joined by the electric utility industry, the mineworkers, and many other industries which rely on reasonably priced railroad transportation urge passage of bills pending in the Senate (S. 1082) and in the House (H.R. 2584).

The 1980 Act has brought benefits in some areas, notably where rail carriers and shippers have been successful in negotiating long term contracts for specific railroad movements as first allowed under the 1980 Act. However, the comprehensive goals and related policy provisions of the 1980 Act are seriously undermined by the Commission's failure to provide a regulatory process that balances the needs of carriers, shippers, and the public, as required in the goals expressed in Section 3 of Public Law 96-448, the Staggers Rail Act of 1980.

This failure is underscored by the Commission's cavalier disregard of a key mandate expressed in Section 10101(a), Subtitle IV, Title 49, United States Code, the Interstate Commerce Act, as amended by the 1980 Act that in regulating the railroad industry, it is the policy of the United States Government * * * to maintain reasonable rates where there is an absence of effective competition.

Today America's coal and coal transportation network are well positioned to secure a full share of domestic and international energy markets in the 1980s, 1990s, and beyond. The possibilities are great by virtue of our abundant coal reserves, our capacity for producing greatly increased amounts of coal, and capabilities of rail and water carriers to furnish reliable and efficient coal transportation services. From these perspectives, the future is bright. Yet, there is a counterproductive cloud of uncertainty in this bright future, namely, whether railroad coal transportation rates will raise coal's delivered price so high as to lose an appreciable portion of coal's potential share of energy markets.

Coal prices at the mine are stable and coal-carrying railroads are in a strong financial position. The unfortunate uncertainty as to whether America's coal will reach its full potential in energy markets lies in the unwillingness of the Commission to implement the 1980 Act in a balanced manner.

Mr. Chairman, I have attached a chart identified as Exhibit A to my testimony to show that coal prices at the mine are stable. During the previous four years, mine prices of coal increased only one-half as much as the increase in the Bureau of Labor Statistics' Producer Price Index for all commodities. However, as shown on a second chart labeled Exhibit B, in the same four years railroad coal traffic rates increased one and one-half times as much as the increase in the BLS Producer Price Index. This amounts to a three-to-one comparison of increases in rail rates in relation to mine prices of coal, and is s clear signal that railroad coal traffic rates are climbing at an alarming pace.

Coal-carrying railroads are financially sound. In 1981, average rates of return on equity of coal-carrying railroads were 11.25 percent. Furthermore, under new methods of financial reporting established by the ICC, these rates should be raised by a factor of about 1.2 times. Thus, the rates of return on equity, if stated using the newly adopted reporting methods, were about the same as for manufacturing as a whole, which amounted to about 13.60 percent in 1981. Moreover, to underscore their financial strength, since 1980 the railroad's internal cash flow has been adequate to meet, and to exceed, capital expenditures attributable to the delivery of railroad transportation services.

Mr. Chairman, a sound railroad industry is important; therefore, we supported the 1980 Staggers Rail Act. We did so because the Act: (a) preserved a reasonable degree of captive shipper protection; (b) authorized the use of railroad transportation contracts; (c) improved railroad pricing flexibility to furnish adequate railroad revenues and provide good financial strength across the rail industry; (d) enabled railroads to reduce costs of providing transportation services; and (e) eliminated certain unnecessary and excessive regulation of the railroad industry.

Railroad revenues have been enhanced significantly by the Act's creation of a cost recovery index adjusted quarterly to account for inflation, establishment of a zone of rate flexibility allowing rail rates to be increased above inflation each year in specified percentages, and encouragement of railroad transportation contracts which assure revenues over certain time periods in relationship to prescribed rates for movements covered by contractual agreements. Furthermore, under the Act, movements are not under Commission jurisdiction with regard to rate reasonableness unless the rates exceed the variable costs of providing services by specified threshold percentages, representing a substantial reduction in rate regulation.

As expressed in a May 25 letter to the President signed by 27 chief executive officers of major coal companies who previously supported the 1980 Act, "implementation of the law by the ICC has ignored captive shipper protection to such an extent that the desirability of reduced regulation of the railroads is now open to serious question." The coal company chief executive officers have urged the President "to appoint to vacant positions on the Interstate Commerce Commission individuals who will recognize, as Congress did by passing the Staggers Rail Act, that adequate protection for captive shippers must be continued and that reduced regulation of the railroads is feasible only where sufficient competition exists to ensure reasonable rates."

With difficulties created by the Commission after the 1980 Act in mind, in April H.R. 2584 was introduced in the House of Representatives and S. 1082 was introduced in the Senate. These bills would require the Commission to adhere to the comprehensive goals, policies, and provisions of the 1980 Act with regard to railroad ratemaking. Both of the bills define railroad market dominance in the Interstate Commerce Act, prohibit the Commission from exempting market dominant railroad traffic from regulation, and provide the Commission with guidelines for standards in regard to maximum rail rates and the determination of railroad revenue adequacy. We believe that passage of this legislation is essential to assure sound implementation of the 1980 Act.

The thrust of the legislation is to restore in the regulatory process the balance furnished in the 1980 Act, particularly to see that captive shipper protection against rail rate abuses will not be eroded through unwarranted, de facto total deregulation of market dominant traffic through regulatory exemptions and adoption of new standards for rates and revenues designed to encourage railroads to charge excessively high prices for services required by captive shippers.

The Commission has demonstrated that, without action of the Congress, the Commission will eliminate captive shipper protection in several ways: (a) by making it virtually impossible for shippers to show the existence of railroad market dominance in a timely fashion; (b) by adopting standards for rail rates and railroad revenue adequacy that impose "bounties" on captive traffic, especially coal traffic; and (c) by granting exemptions from regulation with regard to coal movements which are captive to the railroads, having no effective transportation alternative available.

There are several areas in which the Commission's failure to protect captive coal shippers is most evident. These focus on determination of railroad market dominance, railroad exemption of export coal traffic, railroad coal rate guidelines, and disregard of the Long-Cannon amendment.

In July 1981, in Ex Parte No. 320 (Sub-No. 2), seven months after the Act was signed into Law, the ICC changed the rules for determining railroad market dominance, a decision which seriously erodes captive shipper protection by injecting the question of geographic and product competition into evidence as to the existence of market dominance in transportation. Whether a shipper could obtain a commodity from a different source or could substitute a different commodity for the freight at issue simply has no bearing on whether there is effective competition for the transportation of commodities between traffic originations and destinations such as mines and utility and industrial plants and ports engaged in transshipments from rail to water carriers.

The question of railroad market dominance is concerned with whether transportation competition exists for moving the same commodity from the same origin to the same destination, not, as the Commission has decided in Ex Parte No. 320 (Sub-No. 2), whether optional sources or substitutes could be selected for the commodity in question.

Last month, in Ex Parte No. 346 (Sub-No. 7), the Commission decided, effective September 12, 1983, to exempt, or to deregulate, export coal traffic. Such traffic is widely captive to the railroads for movement to deep draft ports for transshipment by ocean vessels and to shallow draft river ports for transshipment by inland water carriers. This recent action of the Commission directly circumvents captive shipper protection provided in the Interstate Commerce Act.

In February the Commission proposed railroad coal rate guidelines in Ex Parte No. 347 (Sub-No. 1) which endorse excessive increases in railroad coal traffic rates. The Commission proposes to allow coal rate increases of 15 percent per year above inflation, an arbitrary and wholly unacceptable "bounty" improsed on captive coal traffic.

Mr Chairman, I have appended Exhibit C to my testimony to illustrate the gravity of this proposal. The Commission's proposal to phase-in rate increases on captive coal traffic, together with an estimated annual inflation rate of five percent, would result in over a fourfold increase in railroad coal rates between 1983 and 1990. A $10.00 per ton rate would be increased to $45.20 per ton. Increases of this magnitude raise grave concern about the inconsistency of the Commission's proposals in light of the nation's energy policy. Our energy policy clearly calls for use of America's coal and less dependence upon foreign oil, but this is in jeopardy if coal's delivered price becomes substantially higher due to excessively high rail rates for coal movements.

Coal rates already have increased 53 percent in four years. They could double in another four to five years under this proposed scheme. The proposal exceeds by far the rate flexibility provisions of the 1980 Act, which permitted rates to be increased up to six percent per year above inflation, not to exceed 18 percent in four years following enactment. Thereafter, an additional four percent per year can be imposed until any rail carrier which is not already revenue adequate becomes revenue adequate.

Therein lies another problem. The Commission utilizes a rate of return equated to the current cost of capital, without any rationalization of the railroad rate base, as a single criterion for measuring revenue adequacy. This should not represent the sole criterion for judging whether a railroad has adequate revenues. Other indicators of financial strength also should be examined and the calculation of return should be based only on investments which are used and useful in providing transportation services, depreciated to present value utilizing commonly accepted, uniform accounting practices and principles. Otherwise, even though in reality a railroad has adequate revenues to maintain financial soundness, blind adherence to a target rate of return calculated using a grossly overstated rate base will lead the Commission to forever judge the railroads to be revenue inadequate.

Perhaps one of the most noteworthy of the instances in which the Commission is not responsive to the Congress is the Commission's lack of interest in fulfilling the mandate embodied in the Long-Cannon amendment in the 1980 Act. The Commission casually disregards this important provision, which requires that the Commission consider certain factors in the course of determining whether a rate is reasonable, including:

The amount of traffic which is transported at revenues which do not contribute to going concern value and efforts made to minimize such traffic;

The amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and

The carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues.

One of the particularly telling instances of the Commission's insensitivity to the needs of captive coal shippers is highlighted by views of the House and Senate Conferees in their joint explanatory statement on the 1980 Act. The conferees stated that the rail transportation policy set forth in the Act is to encourage and promote the transportation of coal by rail in accordance with the objective of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition. Our studies show that 85 percent of coal carried by the railroads lacks any efrfective competition for the traffic. Thus, the circumstances I have cited clearly show that the Commission has seen fit to implement the 1980 Act without regard to rate abuses faced by captive traffic and in constant pursuit of total deregulation of captive traffic, notwithstanding the provisions of the Act intended to protect captive shippers.

Railroad rate abuses faced by captive coal shippers due to inadequate implementation of regulatory protection furnished in the law on the part of the Commission stands to cause declines in utilization of America's coal by 1985, 1990, and 1995, if the Commission fails to reverse its course. Recent evidence is presented in a soon to be published report of the Energy Information Administration, U.S. Department of Energy, entitled "Railroad Deregulation: Impact on Coal". The report summary notes that "higher rail transportation rates have a sizeable impact on U.S. coal production and consumption." The summary reveals that an analysis of the Commission's recent actions with regard to railroad coal rate guidelines and revenue adequacy, as well as deregulation of export coal traffic, indicates that, if no corrective action is taken, coal production would decline by 2.3 percent from base case projections in 1985, 5.0 percent in 1990, and 5.4 percent in 1995. Western coal production would be exepcially affected reflecting longer distances for western coal movements, with declines in production of 7.4 percent in 1985, 15.2 percent in 1990, and 13.3 percent in 1995, compared with base case projections in each year.

Certainly, Mr. Chairman, it must be quite evident that immediate measures are called for to bring the balance among needs of carriers, shippers, and the public called for in the 1980 Act to fruition in the regulatory process. We believe that this can be accomplished through a threshold combination of strategies. First, the pending legislation, S. 1082 and H.R. 2584, should receive prompt consideration to correct inequities now faced by shippers captive to railroads. Second, extra care must be given to nominations for vacant seats on the Commission, placing special attention to the experience, objectivity, and impartiality of persons nominated with respect to treatment of carriers, shippers, and the public. Third, the Congress, through oversight committees, should hold hearings each year at which all of the commissioners join Members of the Congress, rail carriers, shippers, consumers, and other interests in examining how well the provisions of the Interstate Commerce Act are working in relationship to the soundness of the rail industry and the delivery of fair and equitable railroad transportation services by rail carriers for all railroad traffic.

In conclusion, Mr. Chairman, we believe that railroads always will have an important role in our nation's multi-modal freight transportation network. Railroads will continue to provide vital transportation services essential to our nation's commerce and industry and the likelihood of full utilization of our abundant and secure energy resource, coal. We urge this committee to quickly implement the concerted threefold approach that I have just outlined to avert serious problems and unfortunate losses due to inadequate implementation of the 1980 Staggers Rail Act in the regulatory process. I will be glad to respond to questions. Thank you for allowing me to appear before you on behalf of the National Coal Association.

[Exhibits A, B, and C follow:]

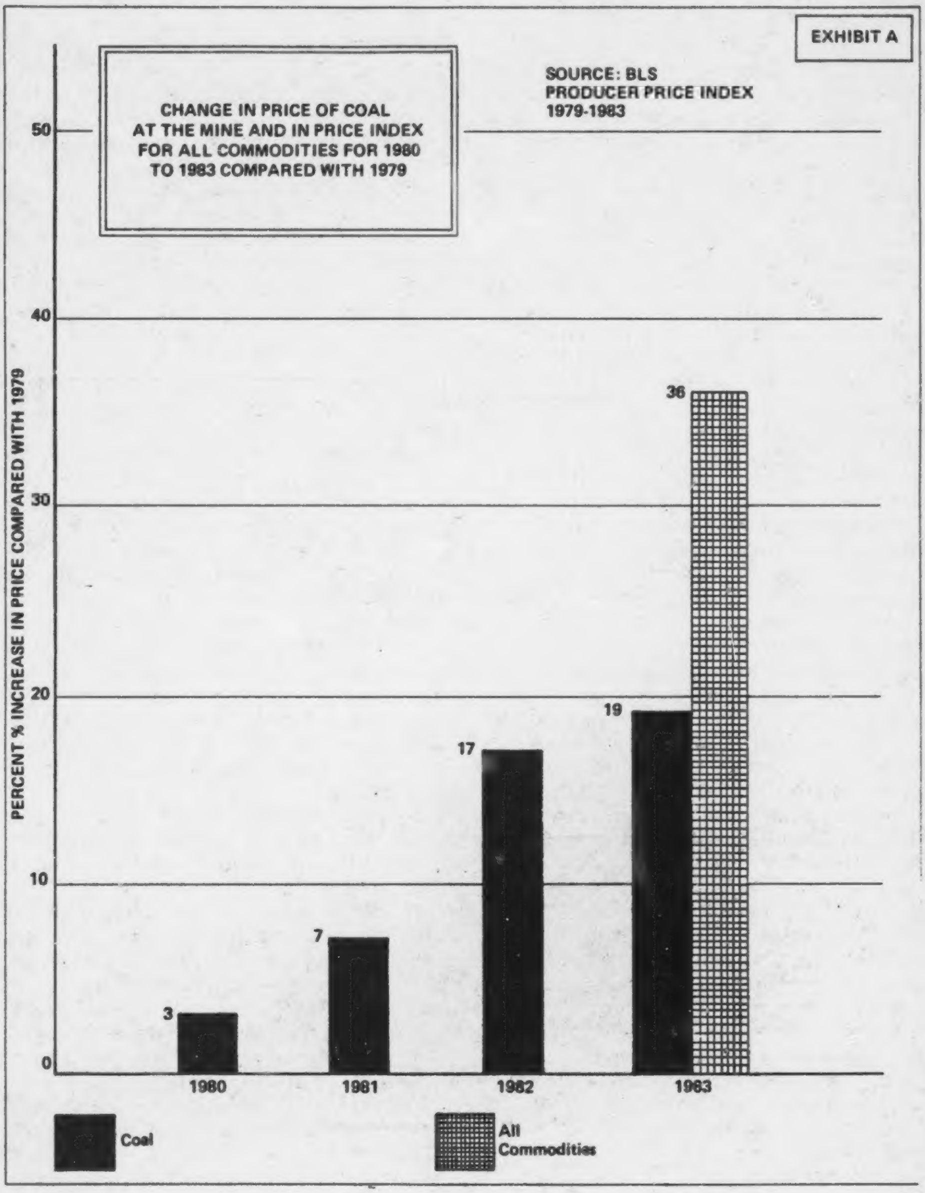


EXHIBIT A
CHANGE IN PRICE OF COAL AT THE MINE AND IN PRICE INDEX FOR ALL COMMODITIES FOR 1980 TO 1983 COMPARED WITH 1979
SOURCE: BLS
PRODUCER PRICE INDEX
1979-1983
PERCENT % INCREASE IN PRICE COMPARED WITH 1979
50
40
30
20
10
0
3
7
17
19
36
1980
1981
1982
1983
Coal
All Commodities

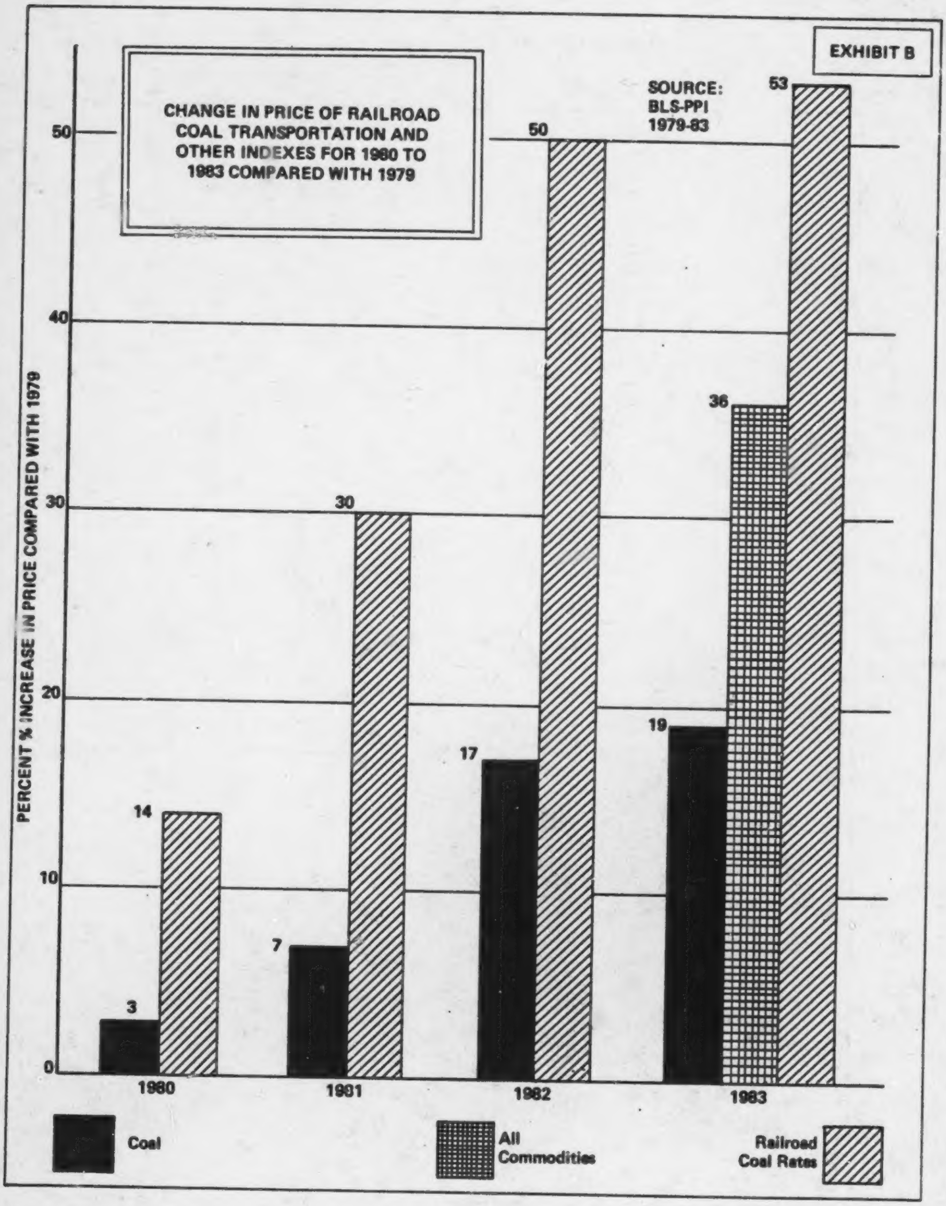
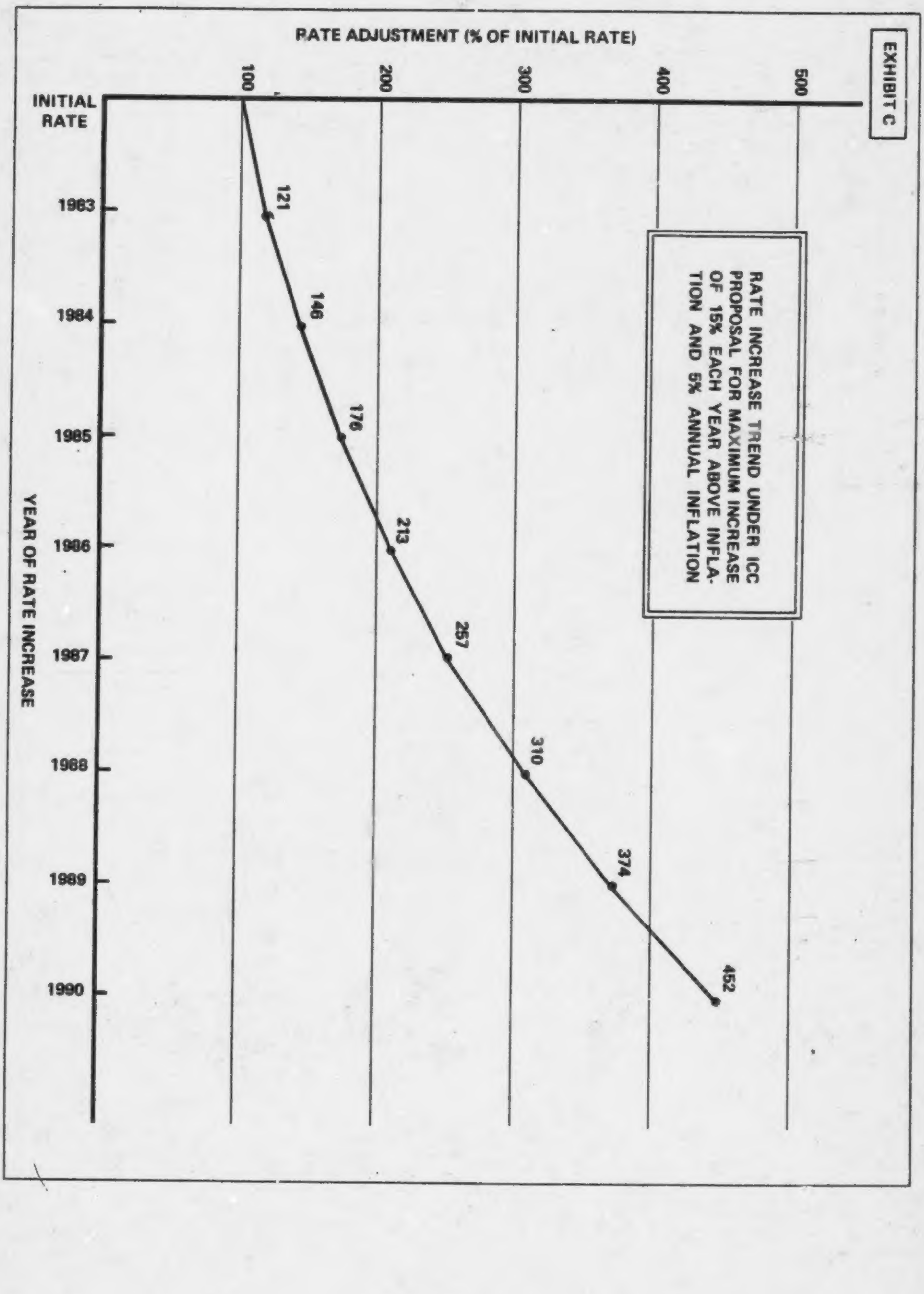


EXHIBIT B
CHANGE IN PRICE OF RAILROAD COAL TRANSPORTATION AND OTHER INDEXES FOR 1980 TO 1983 COMPARED WITH 1979
SOURCE: BLS-PPI 1979-83
PERCENT % INCREASE IN PRICE COMPARED WITH 1979
0
10
20
30
40
50
3
14
7
30
17
50
19
36
53
1980
1981
1982
1983
Coal
All Commodities
Railroad Coal Rates

EXHIBIT C



RATE INCREASE TREND UNDER ICC PROPOSAL FOR MAXIMUM INCREASE OF 15% EACH YEAR ABOVE INFLATION AND 5% ANNUAL INFLATION

Senator DANFORTH. Thank you very much, Mr. Ogden.

Mr. Walker.

Mr. WALKER. Mr. Chairman and members of the subcommittee: My name is C. Alan Walker and I am president of Bradford Coal Co., Inc. Bradford Coal was founded in 1935 and has been shipping coal by rail since that time. Our mining operations are located in Clearfield County, Pa., and beginning with the formation of the Penn Central Railroad and later Conrail, we have been a captive shipper.

We are a medium-sized coal company producing between 1.4 million and 2 million tons annually. Approximately 40 percent of our production moves to the ultimate customer by Conrail, and the balance moves by truck. We ship coal to eight Northeastern States for the domestic steam market and export coal to 10 foreign countries for the international metallurgical market. We are a medium-sized Conrail customer.

With this as background, I would like to give my observations on how Conrail has performed under the Staggers Rail Act of 1980 from a captive coal shipper's point of view. If the central question is, has Conrail been more competitive under the ratemaking decisions of the Staggers Act and have they been more responsive to customer and shipper needs, the answer in my opinion is a resounding yes.

In an industry that has been so regulated for so many years, it appears to me that Conrail has rediscovered the meaning of the word "competition." If we assume that competition within rail ratemaking is good, the effect of the Staggers Act, as Conrail management has adopted to it, has been good.

The old system for ratemaking was a disaster, and it is hard to believe such a rigid structure could develop in our free market economy. There was no flexibility to look at the various components of the transportation system or to examine individual movements and shipments for competitive ratemaking. This is one reason why so much rail traffic was lost to the trucking industry over the years—a complete lack of flexibility.

The rail rates our customers had to pay are a good example of the ultimate distortion that came about in the marketplace. As I said, Bradford Coal is in Clearfield County, Pa., on the eastern edge of the Appalachian Plateau. It is located west of the geographic center of the State, and this location makes us the easternmost major bituminous coal-producing county in the country. We are closer than any competing bituminous coalfields to the industrial markets of New England, upstate New York, and the Middle Atlantic States. We are only 250 miles by rail from the port of Philadelphia, which gives us easy access to the world coal market.

For purposes of ratemaking, we are located in Conrail's Clearfield district. Another major Conrail district is Fairmont, W. Va. The Fairmont district is nearly 250 miles southwest of the Clearfield district, which means that it is an average of 250 miles further from the New England and the other major markets that I mentioned than the Clearfield district.

However, for the past 30 years the rate difference from the Fairmont district has been maintained at 25 cents per ton above the Clearfield rate. That means that coal could move into New England right through Clearfield County, Pa. from a point 250 miles farther west for only 25 cents per net ton.

When this rate was first established, the rates to New England were $3 and $3.25 respectively; however, they ultimately increased to $16 and $16.25. The result was an unrealistically low rate for the Fairmont district, subsidized by an unrealistically high rate from the Clearfield district, and the distortion grew over the years. A great deal of coal movement at the eastern end of the Clearfield district was lost to the trucking industry because the railroad did not have the flexibility to compete for this business.

From my experience, under the new flexibility granted in the Staggers Act, things are beginning to change. Conrail has a much greater ability to react to market forces. They need the flexibility to price against this market.

Conrail now has the ability to make contract rates with export buyers who are willing to guarantee certain annual tonnages. This is an aggressive marketing strategy on the part of Conrail and has helped us increase our rail business from 39.6 percent of our shipments in 1980 to 46 percent today in 1983, and has helped increase our export business from 7.7 percent of our shipments in 1980 to 21.3 percent of our business to date in 1983.

Our marketing strategy has completely changed as a result of these new export rates. We can do much better planning in our operations and have the flexibility to target the business where we can be competitive.

The freedom to set rates that react to actual market forces has given Conrail an ability to compete with other modes of transportation. For the first time in many years, Conrail is actually giving rates that are competitive to trucking rates and is beginning to regain a portion of the business that was lost years ago.

There is no doubt the old rates were a series of cross-subsidies, and the loss of a subsidy can be very painful. Currently, all segments of the coal industry, domestic and export, steam and metallurgical, are in a severe slump and some shift in business which is being blamed on the Staggers Act may be the result of a poor market. Therefore, before reacting to these cries and permanently amending the Staggers Act, we should wait to see what happens to rates and to the coal business in a normal market.

As for Conrail's performance, from my observation there have been no attempts to gouge captive shippers and Conrail appears to be ready to show the other carriers that competitive ratemaking really works.

One other comment. I witnessed a Conrail train loaded at our plant derail 16 times before it traveled 9 miles to the Clearfield yard when Conrail was at its low ebb. With the renovation that has gone into the track and the fixing up of the physical plant, it is in excellent shape.

Also, during that low ebb in 1979, we made our last house coal delivery when a Conrail train jumped the track and dumped 16 cars of coal over a house located about 100 feet from the tracks.

We had to go through the worry of whether or not we were going to have a railroad, and when you go through that you do not mind paying a little bit more for the service.

Thank you.

[The statement follows:]

STATEMENT OF C. ALAN WALKER, PRESIDENT, BRADFORD COAL CO., INC.

Mr. Chairman: My name is C. Alan Walker, and I am President of Bradford Coal Co., Inc. Bradford Coal was founded in 1935 and has been shipping coal by rail since that time. Our mining operations are located in Clearfield County, Pennsylvania, and beginning with the formation of the Penn Central Railroad and later Conrail, we have been a captive shipper.

We are a medium-sized coal company producing between 1,400,000 tons and 2,000,000 tons annually. Approximately forty (40 percent) percent of our production moves to the ultimate customer by Conrail, and the balance moves by truck. We ship coal to eight northeastern states for the domestic steam market and export coal to ten foreign countries for the international metallurgical market.

With this as background, I would like to give my observations on how Conrail has performed under the Staggers Rail Act of 1980, from a captive coal shipper's point-of-view.

If the central question is: Has Conrail been more competitive under the ratemaking provisions of the Staggers Act, and have they been more responsive to customer and shipper needs, the answer, in my opinion, is a resounding yes. In an industry that has been so regulated for so many years, it appears to me that Conrail has rediscovered the meaning of the word competition. If we assume that competition within rail ratemaking is good, the effect of the Staggers Act, as Conrail management has adapted to it, has been good.

In addition to some new competitive innovation, from what I observe, Conrail has concentrated its traffic through the most efficient routes and the lowest cost yards and junctions. This has reduced costs and recaptured some of the traffic lost to other modes in the past. Through competitive ratemaking, it appears Conrail has gained in their competition with trucking for the longer distance hauls, and, overall, they are beginning to look like a winner.

If Conrail management stays on its present course, Conrail may ultimately generate a return on investment attractive enough to put the railroad back into the private sector.

The old system for ratemaking was a disaster, and it's hard to believe such a rigid structure could develop in our free market economy. Rates were certainly not linked to costs. There was no flexibility to look at the various components of the transportation system or to examine individual movements and shipments for competitive ratemaking. This is one reason why so much rail traffic was lost to the trucking industry over the years—a complete lack of flexibility.

The rail rates our customers had to pay are a good example of the ultimate distortion that came about in the market place. As I said, Bradford Coal is in Clearfield County. Pennsylvania, on the eastern edge of the Appalachian Plateau. It's slightly west of the geographic center of the state, and this location makes us the easternmost major bituminous coal-producing county in the country. We are closer than any competing bituminous coal fields to the industrial markets of New England, upstate New York and the Middle Atlantic states. We are only 250 miles by rail from the port of Philadelphia, which gives us easy access to the world coal market.

For purposes of ratemaking, we are in Conrail's Clearfield District. Another major Conrail district is Fairmont, West Virginia. The Fairmont District is nearly 250 miles southwest of the Clearfield District, which means it is an average of 250 miles farther from New England and the other major markets I mentioned than the Clearfield District. However, for the past thirty years, the rate difference from Fairmont has been maintained at 25 cents ($.25) per ton above the Clearfield rate. That means that coal could move into New England right through Clearfield County, Pennsylvania, from a point 250 miles farther west for only 25 cents ($.25) per ton. Coal was moving 250 miles for 25 cents ($.25). When the rate was first established, the rates to New England were $3.00 and $3.25, however, they ultimately increased to $16.00 and $16.25. The result was an unrealistically low rate for the Fairmont District, subsidized by an unrealistically high rate from the Clearfield District, and the distortion grew over the years. A great deal of coal movement at the eastern end of the Clearfield District was lost to the trucking industry because the railroad did not have the flexibility to compete for this business.

Using a profitable segment of the freight business to subsidize an unprofitable or higher-cost segment of another portion of the freight business is no different than the way freight service was used to subsidize passenger service for so many years. The results were inefficiency and noncompetitive ratemaking. The railroads were ultimately pricing themselves out of many segments of the business.

From my experience, under the new flexibility granted in the Staggers Act, things are beginning to change. Conrail has a much greater ability to react to market forces. They need the flexibility to price against this market.

Until 1978 Bradford Coal was shipping all rail coal from five separate sidings on a single-car or less-than-trainload rate. We could make a unit train, or 7,000-ton, shipment by combining coal cars loaded at several sites. However, there was no great savings to Conrail to do things this way. In 1978, Bradford Coal invested $17 million in a new centralized coal preparation plant which included a $3 million unit train floodloading facility and a $2 million railroad loop to our plant from the branch line running through the area. As a result of our investment, we can load a 13,000-ton (135-car) unit train in motion in about four hours.

The railcars and locomotives can come to our plant, be loaded with the locomotive pulling the train and never enter a rail yard for sorting or classification. There is a tremendous savings to Conrail to be able to operate this way, and they should be able to share some of this savings by offering a better rate to the ultimate customer. This is exactly what they have done. We also have the ability to stockpile 75,000 tons of clean coal at our plant for loading. This means we can load a Panamaxsize vessel through the port of Philadelphia and put 50,000 tons on the rail in only a few days. There is a tremendous savings to Conrail to operate this way, and, under the Staggers Act, they have the ability to make contract rates with export buyers who are willing to guarantee certain annual tonnages. This is an aggressive marketing strategy on the part of Conrail and has helped us increase our rail business from 39.6 percent of our shipments in 1980 to 46.0 percent to date in 1983 and has helped increase our export business from 7.7 percent of our shipments in 1980 to 21.3 percent of our business to date in 1983 (See Exhibit I). Our marketing strategy has completely changed as a result of these new export rates. In the past, we would try to load a portion of a vessel through B & O's coal pier at Curtis Bay, Baltimore. Now, we load entire vessels through Conrail's coal pier at Philadelphia. We can do much better planning in our operations and have the flexibility to target the business where we can be competitive.

For the first time in many years, Conrail is actually giving rates that are competitive to trucking rates and are beginning to regain a portion of the business that was lost years ago. This change won't occur overnight, but customers and shippers are now asking Conrail for rates on shipments that, just a few years ago, everyone assumed would move by truck. Freedom to set rates that react to actual market forces has given Conrail an ability to compete with other modes of transportation. They are also offering excellent rates to export customers in exchange for long-term commitments in an effort to shift more of the business from the spot to the contract market. Again, this greatly aids future planning.

By allowing Conrail and other carriers to price competitively and to reduce their rates on low-cost routes to meet the competition, the revenues for the carriers and their contribution can be increased without raising rates nearly to the extent that would have otherwise been required.

There's no doubt the old rates were a series of cross-subsidies, and the loss of a subsidy can be very painful. Those who are complaining now about the provisions for ratemaking under the Staggers Act were probably receiving the benefit of some form of subsidy under the old system, making them artificially competitive. Before reacting to these cries and prematurely amending the Staggers Act, we should wait to see what happens to the rates and to the coal business in a normal market.

Currently, all segments of the coal industry, domestic and export, steam and metallurgical, are in a severe slump, and some shift in business, which is being blamed on the Staggers Act, may be the result of a poor market. Overseas demand is down because of the world-wide recession, and the dollar is very strong, presently making U.S. coal more expensive in our major foreign markets. There's certainly no one single cause for the slump.

As for Conrail's performance, I would give them an A+ for their efforts to try to increase the profitable portion of their business under the provision of the Staggers Act. From my observation, there has been no attempt to gouge captive shippers, and Conrail appears to be ready to show the other carriers that competitive ratemaking really works. Ratemaking had to change or the users of rail service would have been forced one by one to look elsewhere for alternatives.

EXHIBIT I.—BRADFORD COAL CO., INC., BIGLER, PA., RAIL SHIPMENTS AND COAL EXPORTS, 1980 THROUGH 1983

	Total rail shipments	Percent	Total exports	Percent	Total tons
1980	666,044	39.6	130,138	7.7	1,683,479
1981	716,310	40.5	318,961	18.0	1,770,061
1982	573,186	41.0	154,377	11.0	1,398,785
1983 [1]	337,381	46.0	156,748	21.3	736,266

[1] Through June 30, 1983.

EXPORT RATES (PIER 124—PHILADELPHIA), CONRAIL CLEARFIELD (BASE) DISTRICT

	Rate per net ton	Bradford coal export tonnage
Sept., 1, 1980	$13.06	[1] 130,138
Dec. 31, 1980	13.71	
Jan. 17, 1981	13.82	[2] 318,961
Feb. 20, 1981	13.94	
Mar. 18, 1981	14.01	
Apr. 7, 1981	14.09	
June 5, 1981	14.09	
July 1, 1981	14.40	
July 4, 1981	14.40	
Sept. 7, 1981	14.40	
Oct. 1, 1981	14.60	
Oct. 2, 1981	14.87	
Dec. 24, 1981	14.29	
Jan. 1, 1982	14.96	[3] 154,377
Mar. 14, 1982	14.96	
Oct. 11, 1982	[4] 13.90	
	[5] 13.40	
July 1, 1983		[6] 157,748

[1] 1980. [2] 1981. [3] 1982. [4] Single car. [5] Train load. [6] Through June 30, 1983.

Senator DANFORTH. Mr. Scahill.

Mr. SCAHILL. Thank you, Mr. Chairman.

I am executive vice president of the Pennsylvania Coal Mining Association, a trade association of 160 coal companies and over 100 related service and supply companies. We represent 80 percent of the surface mine production in Pennsylvania. Our statement is intended to give you our view in Pennsylvania on the Staggers Act.

While the act was short of wholesale deregulation, it substantially eased the regulatory burden on the railroad industry, providing significant changes in rules governing ratemaking, car control, and other areas. Historically, the coal industry has depended upon the railroads for the bulk of the transportation of our products.

What we do not understand is, the Staggers Act was welcomed by the entire industry in 1980 as a method to force competitiveness among railroads. After only 1½ years of deregulation, many in our industry advocate opening up the act.

PCMA disagrees with that position, for we believe that the full impact of the Staggers Act has yet to be felt. As Mr. Walker mentioned, the entire coal industry is experiencing a depressed buyer-oriented market. Concerning the chart, where I saw an average $27 a ton for 1982 by Mr. Dempsey—I have 160 coal companies who would like to get $27 a ton for their coal today.

PCMA believes we should allow the act to remain unchanged until it has had the opportunity to work in normal competitive markets. To us, the ones complaining about the rates under the Staggers Act are the ones most afraid of change and are also afraid to compete in an open market. Many of these changes have brought unfamiliar results.

Pennsylvania is served by 11 railroads, but the bituminous coal industry of Pennsylvania is served mainly by Conrail, and to a lesser extent the Chessie System and some of the smaller regional railroads. It is important to note that most of our operators in the association are classified as captive shippers, and that our operators' experience with the results of the Staggers Act has been generally favorable. Most of our operators are in Conrail's domain.

Deregulation through the Staggers Act has brought about a keen competitive environment that shippers have found refreshing. For the first time in many years, we can truly negotiate contracts with the railroads on a competitive basis. Also, we feel with the cost-plus basis of accounting that the railroads have been put on has been good for us.

The most extensive changes are in the provisions for ratemaking. While protection for rail-dependent shippers was retained, we believe it was the intent of Congress that the disciplines of the competitive marketplace control most ratemaking.

The new rate provisions curtail activities of rate bureaus and phase out general rate increases, while offering flexibility—and that is a key word—in setting rates. In the past, the coal industry was hampered by rail rates that could take up to 2 years to change. Therefore, changes in the overall delivered price of coal that changed in the marketplace were totally absorbed by our shippers. Today, changes in rail rates can be accomplished in a matter of days to reflect changes in overall prices of coal.

The only problem we have seen in the last 1½ years is in joint rates and combination rates as far as Conrail is concerned. We have had some concern for our smaller regional railroads that have been forced—due to the maneuverings of the largest carriers—to charge higher than competitive rates. Conrail has cancelled joint rates for the majority of its interline and intraline traffic, and our smaller railroads are finding that that is a problem because they're forced to use a combined rate or charge more than what the competitive rate would be.

We also feel that the Staggers Act has caused modernization of loading facilities. Shippers can receive special reduced rates if they can show a reduction in Conrail's rate or Conrail's cost, thereby providing incentives for shippers to modernize their facilities.

Also, we feel Conrail has moved ahead in many areas, such as the West Virginia strategy that was outlined, line rehabilitation and loading guarantees. As far as export coal, we feel that the deregulation of export coal will not cause any problems. It will be similar to the domestic coal situation.

The rates for pier 124 in Philadelphia have gone down, and we also have a permanent rate until December 1984 of $13.40 per ton on coal going through pier 124. And we believe that, all in all, some of the other railroads ought to look at Conrail and some of their innovative marketing techniques—Conrail is trying very hard to become competitive.

Thank you.

[The statement follows:]

STATEMENT OF JAMES V. SCAHILL, EXECUTIVE VICE PRESIDENT, PENNSYLVANIA COAL MINING ASSOCIATION

Gentlemen: I am James Scahill, Executive Vice-President of the Pennsylvania Coal Mining Association (PCMA). PCMA is a trade association of 160 coal companies and over 100 related service and supply companies, who collectively represent over 80 percent of the surface-mined production of Pennsylvania coal. One of our member companies is here today to testify. Bradford Coal Company will give detailed descriptions of its individual experience with the Staggers Act of 1980 and the effect it has had on the company. The intent of the association's statement is to give you a broad overview of the current effect of the Act on Pennsylvania surface coal producers.

The Staggers Act of 1980, while short of wholesale deregulation, nevertheless substantially eased the regulatory burden on the railroad industry, providing significant changes in rules governing rate making, car control and other areas of railroading. Historically, the coal industry has depended upon the railroads for the bulk of the transportation of its product. The Staggers Act was welcomed by the entire coal industry in 1980 as a method to force competitiveness among railroads. After only one and one-half years of deregulation, many in our industry advocate opening of the Act. PCMA disagrees with that position for we believe that the full impact of the Staggers Act has yet to be felt. The entire coal industry is experiencing a depressed, buyer-oriented market. PCMA believes we should allow the Act to remain unchanged until it has had the opportunity to work in normal competitive markets. To us, the ones complaining about rates under the Staggers Act are those afraid of change and are also afraid to compete in an open market. Many of these changes have brought unfamiliar results.

Pennsylvania is served by a total of eleven railroads: Conrail, the Chessie System, Bessemer & Lake Erie, Cambria & Indiana, Delaware & Hudson, Lake Erie Franklin & Clarion, Monongahela, Montour, Norfolk & Western, Pittsburgh & Lake Erie, and the Pittsburgh & Shawmut. The bituminous coal industry in Pennsylvania is served mainly by Conrail, and to a lesser extent, the Chessie System and some of the smaller regional railroads. It is important to note that most of our operators in the Association are classified as captive shippers and that our operators' experience with the results of the Staggers Act has been generally favorable.

Deregulation through the Staggers Act has brought about a keen competitive environment that shippers have found refreshing. For the first time in many years, our shippers can truly negotiate contracts with the railroads on a competitive basis. As mentioned, railroads were restricted far more than many other enterprises by regulations concerning their business practices and day-to-day management. The Staggers Act altered some of these restrictions and returned decision-making back to management. One of the key facets of this movement has been in the accounting field where the railroads have been placed on a "cost-plus" basis. This change has also assisted in establishing competition among the rail lines.

For purpose of further discussion, we will testify mainly about our relationship with Conrail since it is the major line with which we deal.

Perhaps the most extensive changes are in the provisions for ratemaking. While protection for rail-dependent shippers was retained, it was the intent of Congress that the disciplines of the competitive marketplace control most ratemaking. The new rate provisions curtail activities of rate bureaus and phase out general rate increases, while offering flexibility in setting rates. In the past, the coal industry was hampered by rail rates that could take up to two years to change; therefore, changes in the overall delivered price of coal that changed in the marketplace were totally absorbed by the shipper. Today, changes in rail rates can be accomplished in a matter of days to reflect changes in overall prices of coal.

The only problem that has surfaced has been in the area of joint and combination rates. A "Joint Rate" is a single price charged for the movement of a shipment via two or more railroads. A "Combination (or Proportional) Rate" is the price for movement over two or more railroads resulting from the addition of the separate price of the individual railroads. Due to the maneuvering of the largest carriers, Conrail has cancelled joint rates for the majority of its interline traffic. This has caused a hardship on the smaller regional railroads within the Conrail system.

Under the combination rate, one of our regional Class III railroads, the Pittsburgh & Shawmut, is forced to charge a rate above the competitive rate to ensure P & S profitability. (See Attachment "A".)

It must be emphasized that this problem of rates is between Conrail and the regional lines, not because of the Staggers Act.

Another benefit of the Staggers Act can be seen in the modernization of loading facilities. Shippers can receive special reduced rates if they can show a reduction in Conrail's cost, thereby providing incentives for shippers to modernize their facilities. In the past, modernization of loading facilities meant nothing in relationship to the fixed rates—a shipper paid the same rate regardless of the efficiency of his operation.

On June 9, 1983, the Interstate Commerce Commission issued a decision to exempt from regulation coal shipped by rail for export. Again, many in the coal industry have argued that deregulation of export coal will be harmful to our industry due to increased rates and loss of coal sales to the world market. PCMA disagrees with that assessment due to the domestic competitiveness we have already witnessed. What has been good for the domestic market, i.e. increased competition, can only hold true in the export marketplace. In fact, deregulation of export coal will eliminate what has been the only regulated element in the total export coal marketing chain consisting of producers, transportation companies and coal consumers. This will require railroads to compete in the rate of price area—something they didn't have to do prior to Staggers, and will permit export coal shippers to effectively compete in foreign markets by tailoring rail transportation to their total delivery requirements. Delivered coal at a specific total cost has become a distinct requirement in the export market. All interests are encouraged to work together as equal partners in the marketing chain. Pennsylvania coal has been known as the "coal of last resort" in world markets. There are indications that the relative position of our coal, while still relatively small, is growing stronger. Much of the credit for Pennsylvania's growth must go to the partnership formed by our producers, state government and Conrail. Recently, Conrail renovated Pier 124 in Philadelphia to assure it has the physical capacity to participate in the growth of the export market. As an indication of the effect of Staggers, one should study the Conrail Export Rates from Clearfield (PA) District since the Act:

September 1, 1980	$13.06
December 31, 1980	13.71
January 17, 1981	13.82
April 7, 1981	14.09
July 1, 1981	14.40
October 1, 1981	14.60
January 1, 1982	14.96
March 14, 1982	14.96
October 11, 1982	13.40
July 1, 1983	13.40

In October of 1982, Conrail guaranteed the rate until January of 1984. Conrail has also initiated several other competitive marketing efforts, including:

West Virginia Strategy: Conrail has reduced rates for low-sulfur West Virginia coal being shipped to Pier 124 to encourage blending with higher sulfur Pennsylvania coal to make the PA coal more suitable to export markets. (See Attachment "B".)

Line Rehabilitation: In 1982 Conrail spent $9.8 Million and in 1983 spent $7 million to improve its coal hauling routes in central and western Pennsylvania.

Loading Guarantees: Conrail guarantees to load vessels at Pier 124 at a rate of 15,000 tons per 24 hours or pay a vessel detention fee to the shipper. (See Attachment "C".)

It is the Pennsylvania Coal Mining Association's belief that Conrail is making an earnest effort to become competitive in both the domestic and export marketplace. That initiative has come about due to the enactment of the Staggers Act of 1980. By allowing the railroads to price competitively and to reduce their rates on low cost routes to meet the competition, their revenues can be increased without raising rates. We ask that the Staggers Act of 1980 be allowed to stand on its own merit until such time that change is needed.

Thank you.

ATTACHMENT "A"—SUMMARY OF INTERIM CONRAIL JOINT RATE, SWITCHING ACTIONS

Conrail cancelled joint rates, effective February 26, 1983, where Conrail reaches origin and destination except for GTW and DTI.

To protect Conrail line haul traffic from diversion as a result of switching cancellations by other carriers, Conrail has made a limited number of 45-day commodity, location specific exceptions from rate cancellations.

Conrail has also implemented a $187 per car allowance to be paid to any shipper who is required, as a result of switching cancellations by other railroads, to pay a separate commercial switch charge to reach Conrail.

Effective February 19, 1983 Conrail established a minimum commercial switching fee of $358 for railroad-owned cars.

Effective March 19, 1983, Conrail will establish a minimum commercial switching fee of $280 for private cars.

Also effective March 19, 1983, Conrail has filed for an increase on its reciprocal switching charges to other carriers to $280 per car from $187 per car.

Also effective March 19, 1983, Conrail has filed to cancel reciprocal switching on paper and coal for account of CSX and NWS. These are the two principal commodities on which Conrail's routing has been cancelled.

ATTACHMENT "B"—WEST VIRGINIA COAL STRATEGY ANNOUNCEMENT

In order to increase throughput at the modernized Pier 124, to increase Conrail and Pennsylvania Coal's participation in lower-sulphur coal markets, and to strengthen the production capacity of Conrail-local mines, Conrail is announcing a new strategy for West Virginia Coal Exports designed to achieve these objectives.

Conrail will publish a tariff designed to draw cargoes of export coal from its Kanawha and New River Districts to Pier 124 in Philadelphia. Provisions of this tariff will include:

Trainload rates annual tonnage levels: $15.90/net ton—applies on first 150,000 tons; $15.40/net ton—applies on next 150,000 tons; $14.40/net ton—applies on tonnage in excess of 300,000 tons.

Shipment size: Minimum of 7,000 tons, maximum of 8,000 tons.

Origins: Maximum of three origins from Conrail Kanawha and New River Districts loaded on one date and served from the same serving yard.

Permitting: 10 days for loading cargo for vessels 55,000 DWT capacity or larger, 6 days for loading cargo for less than 55,000 DWT vessel.

Rate adjustment: Standard tariff adjustments.

Demurrage: Twenty-four hours free time at origin with demurrage of $20.00 per car per day or fraction thereof beyond free time—Standard tidewater demurrage at Pier 124.

Less than trainload rate: $18.40/net ton.

Shipment Size: Less than trainload (LTTL). Origins: Kanawha and New River Districts.

Permitting: Standard permit periods.

Adjustment: Standard tariff rate adjustments.

Demurrage: Standard LTTL demurrage at origin, standard tidewater demurrage at Pier 124.

Equipment: Conrail open top hoppers.

Duration: Tariff will be effective for two years.

Note: One party must be designated as the transshipper responsible for coordination of shipment permits and freight charges for all cargoes involving the movement of Kanawha Valley Coal under the volume rates quoted above. Conrail makes this requirement in order to avoid the high cost of record-keeping, which would otherwise be associated with monitoring the volume requirements of this tariff.

Conrail is also offering two options for accounts interested in contracting for transportation service to Pier 124, either of which produces considerable savings. The differences between the two options are in the level of volume commitment, and penalty for volume shortfall, with other terms the same. The basic contract terms are:

Trainload rates, volume, and penalty:

Option 1: $15.40 per net ton, 300,000 ton minimum annual commitment, $14.40 per net ton applies on tonnage over 300,000 ton annual level, penalty—25 percent of base rate on annual tonnage shortfall.

Option 2: $14.40 per net ton, 500,000 ton minimum annual commitment, penalty—30 percent of base rate on annual tonnage shortfall.

Shipment size: Minimum 7,000 tons, maximum 8,000 tons.

Origins: Maximum of two origins from Conrail's Kanawha and New River Districts loaded on one date and served from the same serving yard.

Permitting: 10 days for vessels 55,000 DWT or larger, 6 days for vessels less than 55,000 DWT.

Rate adjustments: Quarterly RCRI increases and/or reductions.

Demurrage: Twenty-four hours free time to load at origin with demurrage of $20.00 per car per day or fraction thereof beyond free time, standard tidewater demurrage at Pier 124.

Term: Two years.

Equipment: Conrail open top hoppers.

Conrail is also taking another action to achieve the objectives stated earlier. This trust offers incentives for blending West Virginia coal with higher-sulphur Pennsylvania coals served by Conrail to produce a mixture with sulphur content low enough to compete in compliance coal markets overseas. These incentives take the form of rate reductions on a vessel-by-vessel basis, and are offered when the proportion of West Virginia coal loaded in a particular vessel is between 30 percent and 65 percent, inclusive. The amount of this reduction is defined by an equation given below, and results in a maximum reduction from the rates quoted above of $1.00 per net ton when 30 percent West Virginia coal is used, and a minimum of $.46 per net ton when 65 percent West Virginia coal is blended with Pennsylvania origin coal served by Conrail. These rate reductions will be afforded on all trainload and single car rates listed above, including those involving contract offers. The equation is:

$$Y = -1.54\ (X) + 1.46$$

Where:

X = Proportion of West Virginia coal included in the blend.
Y = Rate reduction (dollars per net ton) on the West Vrginia tonnage included in the cargo loaded into the vessel at Pier 124.

[Memorandum]

WEST VIRGINIA TO PIER 124 EXPORT REDUCTIONS

This is to advise you that Conrail has reduced its West Virginia to Pier 124 export coal rates effective June 5, 1983. and increased the attractiveness of these rates by reducing the volume threshhold required for incentive rates.

Recall that the original tariff included the following rate and volume provisions:

Volume and applicable rate (TL):
First 150,000 NT, $15.90/NT.
Next 150,000 NT, $15.40/NT.
Over 300,000 NT, $14.40/NT.

Since that time, N+W contracts tied to a declining RCRI have lowered the N+W competitive price, and the Chessie has entered refund-for-volume contracts. Thus, our base rate had become uncompetitive. To regain our price leadership position, we made the following change in Supplement 4 to Tariff 4806, effective June 5, 1983:

Volume and applicable rate (TL):
First 100,000 NT (1983), $15.00/NT.
Over 100,000 NT (1983), $14.40/NT.
First 300,000 NT (after 1983), $15.00/NT.
Over 300,000 NT (after 1983), $14.40/NT.

Other provisions of the tariff, such as the allowance for blending with Pennsylvania coal, remain the same.

The result of this reduction its that Conrail is about $.40/NT cheaper than its competitors for movements of southern West Virginia coal for export. Please keep this fact in mind when dealing with brokers and traders, consumers of low sulphur coal, and producers located on Conrail or NF&G in southern West Virginia.

ATTACHMENT "C"—CONRAIL GUARANTEES COAL LOADINGS—OR WILL PAY DETENTION FEE

PHILADELPHIA.—Continuing its efforts to encourage the movement of export coal through the recently renovated Pier 124 in South Philadelphia, Consolidated Rail Corporation announced that it is guaranteeing to load vessels at an average rate of 15,000 tons per 24-hour period—or pay a vessel detention fee of $335 per hour, subject to certain limitations. The guarantee is effective today.

Pier 124 is the first railroad-operated coal loading facility in the United States to offer this guarantee, which is effective until October 1, 1983.

Under the guarantee, for example, a vessel taking on 60,000 tons of coal would be loaded within 96 hours. If the vessel-loading process took more than 96 hours, Conrail would pay $335 to the shipper for each full hour of delay, up to certain limits.

"The guarantee is a further demonstration of Conrail's confidence in the dependability of the coal-handling operation at Pier 124," said Warren G. Barber, Conrail's assistant vice president-coal marketing. "And it is further evidence of our commitment to support the marketing of Pennsylvania coal." The coal-loading guarantee tariff containing all details was filed with the Interstate Commerce Commission earlier this month.

In the past year, Conrail has instituted a series of rate and service initiatives to encourage the movement of Pennsylvania coal through the Philadelphia trans-loading facility. Examples of other rate initiatives include:

In October 1982, Conrail rolled back to 1979 levels rates on Pennsylvania bituminous coal moving to Pier 124 for export. The bituminous rates are guaranteed until January 1, 1984. At the same time, Conrail also guaranteed to hold in place January 1982 rates on anthracite coal moving to Pier124 for export until at least January 1, 1984.

In September 1982, Conrail significantly reduced rates to Pier 124 for coal coming from the mines of Kanawha Valley, West Virginia. In early April, 1983 the first vessel to take on coal under those reduced West Virginia rates was fully loaded at Pier 124. It was also the first Panamax class vessel to load coal at Pier 124 and not top off elsewhere.

Since its inception April 1, 1976, Conrail has accomplished a massive rehabilitation of its coal-carrying lines:

In 1982 alone, Conrail spent about $9.8 million to upgrade and improve its coal hauling routes in central and western Pennsylvania and eastern Ohio.

From 1976 through 1982, Conrail has spent $79.2 million to upgrade its coal hauling branch lines in central and western Pennsylvania.

In 1983, another $7 million worth of rehabilitation work is scheduled for this area.

Senator DANFORTH. I think you guys should get an advertising discount from Conrail.

Mr. Ogden, you were here when Mr. Dempsey testified, and he had a lot of statistics. You simply disagree with his numbers, is that correct?

Mr. OGDEN. Yes; I disagree with the numbers, and I also recognize that he chose a timeframe which would support a particular interpretation that I think is misrepresentative of the facts.

Senator DANFORTH. Mr. Walker, do you agree with Mr. Ogden or Mr. Dempsey?

Mr. WALKER. As far as the cost of coal at the mine?

Senator DANFORTH. All of his figures relating to average price of coal, and rail rates.

Mr. WALKER. I would agree that the timeframe was very bad that he picked.

Senator DANFORTH. Bad timeframe.

What is your position, Mr. Scahill?

Mr. SCAHILL. I would agree with the other gentlemen. The timeframe was picked.

Senator DANFORTH. Mr. Ogden, I wonder if you could submit for us a commentary on the numbers that Mr. Dempsey provided us with.[1]

Mr. OGDEN. I would be happy to do so.

Senator DANFORTH. Now, gentlemen, with respect to determining what is effective competition, the ICC includes not only competition in terms of transportation, but also competition in the underlying product, for example whether coal is available from some other source or whether another product such as oil is available to the utility.

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[1] The submission was not reproducible and is in the committee files.

I know Mr. Ogden stated his view that that is not appropriate in determining effective competition. But I would like each one of you to spell out your view on that, whether or not it is appropriate, and if not, why not.

Mr. **Ogden**. Well, I think it is totally not only inappropriate, but it borders on the ridiculous. If you want to talk about other products or geographical areas or in fact how competitive is transportation, as the gentleman from Hastings, or from Kansas City, pointed out, you can get enough trucks to do the job. You can hire pack mules if you want to.

I do not know of a mine in this country where you cannot get that coal out if you have to carry it out on people's backs. But that is so nongermane and it borders on being so ridiculous that it makes no sense at all.

The typical case is you have a coal mine that almost invariably—85 percent of the domestic utility coal is served by mines that have only one meaningful rail transportation, rail mechanism. That is the transportation. One railroad serves that mine.

Senator **Danforth**. Excuse me. That is not quite the question I asked. The question I asked is, they are considering not only other means of competition, not only the availability of other means of competition, but also with respect to the consumer of the product, say the utility, whether they have other sources of coal and whether they have other sources of energy other than coal.

Mr. **Ogden**. Yes; and as the utility spokesman indicated, it takes a lot of time and money to convert from one fuel to another fuel. Likewise, it frequently takes a lot of time and investment to convert from one source to another source.

Senator **Danforth**. Let us suppose that they are available. Let us just assume that that is correct, that they can make the switch.

Is that an appropriate thing to consider?

Mr. **Ogden**. I think it is totally inappropriate. I think the switch can always be made if you totally disregard the impact on the ratepayers of the cost of making the switch. You know, we serve the city of San Antonio, who has had a disastrous experience with the Burlington Northern which I think you are probably aware of. At one time the mayor of San Antonio, Tex., who happens to also serve on the municipal utility board, said they had to seriously consider importing South African coal because they could get that delivered to San Antonio, Tex., cheaper than they could get coal delivered from the Powder River Basin of the United States.

Senator **Danforth**. Mr. Walker?

Mr. **Walker**. My position would be 100 percent opposed to that. I think the ultimate goal of any customer, be it utility or industrial planner or whatever, should be to get the Btu's to their plant for the cheapest dollars. And interregional competition is certainly key, and transportation has to be considered in that.

The competition between the coalfields of West Virginia and Pennsylvania is extremely keen because of that, and the smart buyers in New England and New Jersey and upstate New York are always playing one region against the other, and it has worked to their advantage.

Senator **Danforth**. So you think that the ICC is correct?

Mr. **Walker**. Yes.

Senator **Danforth**. Mr. Scahill?

Mr. **Scahill**. I would agree with that.

Senator **Danforth**. Gentlemen, thank you very much.

That concludes today's hearing, and tomorrow we begin at 9:30 a.m.

[Whereupon, at 1:10 p.m., the subcommittee was adjourned, to reconvene at 9:30 a.m. on Wednesday, July 27, 1983.]

STAGGERS RAIL ACT OF 1980

WEDNESDAY, JULY 27, 1983

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:32 a.m., in room SR-253, Russell Senate Office Building, Hon. John C. Danforth (chairman of the subcommittee) presiding.

Senator DANFORTH. Mr. Wilkins, Mr. Burdakin, and Mr. Gensburg.

Mr. Wilkins.

STATEMENTS OF C. F. WILKINS, CHAIRMAN, PROCOMPETITIVE RAIL STEERING COMMITTEE, ACCOMPANIED BY JOHN F. DONELAN; JOHN BURDAKIN, PRESIDENT, GRAND TRUNK SYSTEM; AND ROBERT GENSBURG, PRESIDENT, LAMOILLE VALLEY RAILROAD CO., ON BEHALF OF THE SHORT LINE LEGISLATIVE COALITION

Mr. WILKINS. Good morning, Mr. Chairman. My name is Charles F. Wilkins. I appear today as chairman of the procompetitive rail steering committee. With me is Mr. John F. Donelan, general counsel of this committee.

We have prepared and submitted our written testimony. I would like to summarize some of its main points.

Members of our procompetitive committee represent industries which are tied to the railroads by production facilities designed for rail service and distribution systems geared to long-distance, high-volume shipments which are generally not adaptable to transportation by truck or intermodal service. Changing our dependence on rail service could not be accomplished without massive capital infusions and prohibitive high increases in operating costs.

The main thrust of our position is that, first, the Staggers Rail Act, particularly in its rail transportation policy, requires the continuing and strengthening of vigorous interrailroad competition.

Second, several railroads, by a program of joint rate and route cancellations, closings of gateways, obstruction or termination of reciprocal switching arrangements are violating the requirements of the Staggers Act calling for interrailroad competition.

Third, the Interstate Commerce Commission is failing to enforce the Staggers Act requirement for interrailroad competition.

Fourth, clarifying legislation is needed to insure that such interrailroad competition mandated by the Staggers Act is continued and strengthened.

In our written testimony, we refer to actions of railroads such as Conrail, the Seaboard Railroad System, the Southern Pacific, and others who have embarked on programs of cancelling joint rates and through routes, closing rail transportation gateways, terminating or dramatically increasing the cost of reciprocal switching arrangements, thereby, sharply reducing the availability to the shipping public of genuine interrailroad competition.

The situation is compounded by the retaliatory actions taken by other railroads. As the Nation's railroads continue to fight and retaliate, it is the shippers, who rely on rail transportation services, that are injured. The availability of these alternative joint rates and through routes provides the means by which the forces of competition operate.

We need these alternatives to insure that a market-disciplined rail industry becomes a reality. This is, of course, occurring against a background of mergers and consolidations, which are creating powerful rail systems such as the Missouri Pacific-Union Pacific, the CSX Lines, the Burlington Northern-Frisco, and the Norfolk Southern.

In the actions taken thus far, there has been an accelerated reduction in the availability of interrailroad competition. Unless something is done promptly, the momentum will increase, and the availability of interrailroad competition will be even further reduced.

Section 101 of the Staggers Act describes the goals and objectives of this legislation. The desirability of competition between and among railroads is stressed repeatedly. Yet, as indicated in our written testimony, time and again the Interstate Commerce Commission has declined to even investigate these joint rate and route cancellations, gateway closings, and other actions that restrict interrailroad competition.

Indeed, the Commission recently denied the petition of the National Industrial Transportation League seeking a rulemaking proceeding looking into the issuance of rules which prohibit the anticompetitive cancellation of joint rates and through routes, the anticompetitive closing of gateways, and the anticompetitive interference with reciprocal switching arrangements.

The track record of the Interstate Commerce Commission is such that clarifying legislation is believed to be essential to make it clear beyond question that one of the basic objectives of the Staggers Act is to enforce and strengthen interrailroad competition.

In concluding these remarks, in the judgment of the procompetitive committee, the Staggers Act was and is sound legislation. One of its most fundamental objectives, expressed repeatedly in the Railroad Transportation Policy, is the achievement of vigorous interrailroad competition. In this area the procompetitive committee is convinced that the Interstate Commerce Commission, as presently constituted, has not been taking the actions required under the Staggers Act to realize or encourage vigorous interrailroad competition.

We are not seeking reregulation. Rather, clarifying statutory language should be enacted which will leave no doubt in the minds of the ICC or anyone else that the Staggers Act objectives of vigorous interrailroad competition must be achieved.

We thank you for the opportunity to present this testimony.
[The statement follows:]

STATEMENT OF CHARLES F. WILKINS, PROCOMPETITIVE RAIL STEERING COMMITTEE

My name is Charles F. Wilkins and I appear today for the Procompetitive Rail Steering Committee, an independently funded group of rail shippers. I am the Manager of the Transportation Analysis and Procurement Department for the Ford Motor Company. I am presently serving as Chairman of the Procompetitive Rail Steering Committee (which, for convenience, I shall refer to as the Procompetitive Committee).

Our Procompetitive Committee represents companies who are specifically concerned with ensuring the continuation and strengthening of inter-railroad competition, contemplated by the Stagger Rail Act. It is the conviction of our companies that the achievement of inter-railroad competition will eliminate a substantial portion of the problems harassing shippers and receivers fundamentally dependent upon the railroads. Hence our Committee is placing its emphasis upon inter-railroad competition and is here concerning itself with that basic problem alone. Our objective is to be helpful to the Subcommittee in facing this critical issue under the Staggers Act.

The Procompetitive Committee greatly appreciates the opportunity to appear and present its views at these oversight hearings on the Staggers Rail Act of 1980, one of the most important, far-reaching laws ever enacted by the Congress pertaining to railroad transportation.

The members of the Procompetitive Rail Steering Committee represent industries which are tied to the railroads by production facilities designed for rail service and distribution systems geared to long-distance, high-volume shipments, which generally are not adaptable to transportation by truck or intermodal service. Changing our dependence on rail service could not be accomplished without massive capital infusions and prohibitively high increases in operating costs. We have plants, representing enormous investments, which are dependent upon the railroads, both in terms of transportation service and in being able to reach essential markets. The absence of genuinely competitive rail rates and rail service to dependent facilities would ultimately result in their retirement or relocation. The cost of premature plant closings is not measured on corporate profit and loss statements alone, but also on the unemployment rolls and local tax receipts to communities across this country. We are confident the Staggers Act did not intend such a result. We are vitally interested in the maintenance of a financially healthy, market-disciplined rail system adequate to move the nation's commerce and support the nation's defense needs.

The Procompetitive Committee strongly supports the objectives of the Staggers Act and believes that in most areas the objectives of the law are well on the way to being achieved. We are here today to express our views and make our recommendations in areas where those objectives are not being realized and, indeed, are being frustrated.

As background and as part of this testimony, I have included with my written statement, as Attachment A, the Position Paper pertaining to the Staggers Act recently adopted by the Procompetitive Rail Steering Committee. We hope our testimony today, supplemented by this Position Paper, will be helpful to the Subcommittee.

APPROACH TAKEN IN THIS TESTIMONY

It is our understanding that the Subcommittee will be focusing particularly on four matters: (1) the financial condition of the railroad industry, revenue adequacy, and recent rail purchases of non-rail assets; (2) the I.C.C.'s proposed coal rate guidelines; (3) route cancellations; and (4) the I.C.C.'s decisions to exempt export coal and boxcar traffic from regulation.

It is our further understanding that the Subcommittee is interested in discussion as to which matters can be resolved by action of the Interstate Commerce Commission (I.C.C.) and which problems require the enactment of new legislation.

As indicated above, the Procompetitive Committee desires to direct its presentation to the subject matter of route cancellations and inherently related matters pertaining to inter-railroad competition.

There is a basic point we wish to emphasize here. The Procompetitive Committee is not seeking re-regulation of the railroad industry. We feel that the Staggers Act has done the job if the I.C.C. were to administer the Act, both in accordance with its letter and its spirit. In our judgment, the I.C.C. has not done so. As a result, the

Procompetitive Committee seeks legislation, where necessary, to clarify the objectives of the Staggers Act aimed at vigorous inter-railroad competition so that this vital objective will be realized to the fullest.

THE URGENT NEED FOR VIGOROUS COMPETITION BETWEEN AND AMONG THE RAILROADS THEMSELVES

On the matter of route cancellation and those issues that are inherently tied to such action, we would like to direct the attention of the Subcommittee to the substantial and growing actions on the part of certain railroads resulting in cancellation of joint rates and routes, closing of natural transportation gateways and removal of economically viable reciprocal switching arrangements designed to provide competitive rail service.

Consolidated Rail Corporation, Seaboard Rail System and Southern Pacific have been prime movers. Other lines have cancelled joint rates and routes, closed gateways and terminated reciprocal switching arrangements. Shippers and receivers have been and are the victims of such actions and counter-actions by the railroads.

Illustrative are the circumstances in No. 38676, "Changes in Routing Provisions—Conrail—July, 1981." Conrail was permitted by the Commission to place in effect changes in routing provisions cancelling, or restricting, the application of joint single-factor through rates via numerous interterritorial gateways on shipments to or from points in Official Territory which Conrail could serve directly. Through a number of gateways which Conrail reached directly, it restricted its participation to movements by Conrail direct. In further action affecting additional gateways on shipments to and from Official Territory, which Conrail does not serve directly through those gateways, Conrail restricted its participation in the application of joint through rates to movements involving Conrail and not more than one of its direct connections (on the portion of the movement that is within Official Territory). The effect of Conrail's proposal was to cancel a large number of joint rates and routes en masse, rather than by particularly identified routes.

The Commission's Decision upholding this action by Conrail was reversed on appeal by the U.S. Court of Appeals for the Sixth Circuit in a Decision dated April 4, 1983. The Court emphasized the necessity of presenting evidence with respect to the individual rates and routes being affected. The Court took particular note of the substantial interest of shippers in the matter involved.

It is important to note that shippers and receivers, when these joint rate and route cancellations occur, and especially these massive cancellations, find themselves helpless to protect themselves. One railroad cuts out another railroad and the shippers dependent upon the latter railroad are deprived of essential competitive rates and service. The cancelling rail carrier is all too often insulating itself from competition from other railroads—to the serious competitive injury of shippers and receivers served by the latter lines.

In I.C.C. Investigation and Suspension Docket No. 9258, "Routing Between Stations Served by Conrail—November, 1982," the Commission had under consideration a protested tariff whereby Conrail was requiring, with limited exceptions, that all rail traffic moving between origin and destination points served by Conrail be restricted to a route of movement via Conrail only. The provision had the effect of closing all routes on which any other carrier is an origin, intermediate or destination carrier in a joint through route, with Conrail serving the origin and destination. Here again is a circumstance of massive, blanket cancellations of joint rates and through routes previously available to the shipping public. These are carried out without regard to the substantial reductions in inter-railroad competition caused by such cancellations and closings.

After a procedural order was issued and parties were preparing their evidence for submission, by Commission Notice served January 11, 1983 not only was the Order of Suspension vacated, but the entire proceeding was terminated.

The Family Lines (now Seaboard System Railroad) on September 8, 1981 filed a tariff cancelling numerous joint rates with Southern Railway System (now part of Norfolk Southern System). This occurred over Southern's strong objection. The Commission declined either to suspend or to investigate. Again inter-railroad competition was significantly reduced, and the shipping public was deprived of the benefit of such inter-railroad competition, contrary to the railroad transportation policy enacted in the Staggers Act.

Southern Pacific has embarked on a program of cancelling joint rates and through routes, with related gateway closings, over objections including those of its principal competition, the Atchison, Topeka & Santa Fe. Here again the I.C.C. declined even to enter an order of investigation. Here again shippers and receivers are being deprived of the benefits of inter-railroad competition.

These kinds of actions by Southern Pacific, Conrail, Seaboard Rail System and other lines, in the view of the Procompetitive Committee, are directly contrary to both the letter and the spirit of the Staggers Act. This is because these railroads have been disregarding and the Commission has not been adequately concerned with the anti-competitive nature and results of these cancellations of joint rates and routes and related closings of gateways.

Section 101 of the Staggers Act describes the goals and objectives of this legislation. The desirability of competition between and among the railroads is stressed over and over. Specifically, it states in regulating the railroad industry, it is the policy of the United States Government (1) "to allow, to the maximum extent possible, competition * * *" Subsection (4) seeks to insure "effective competition among rail carriers * * *" Subsection (5) seeks "* * *to insure effective competition and coordination between rail carriers * * *" Subsection (13) seeks "* * * to avoid undue concentrations of market power * * *"

These cancellations of joint routes and rates, or the closing of gateways, must be truly analyzed to ensure that their actual, primary or substantial purpose is not to eliminate competition by other railroads who have been participating in such joint rates and routes. Deliberate destruction by the cancelling lines of inter-railroad competition is directly contrary to the Staggers Act, particularly the rail transportation policy in § 10101a. Such anti-competitive cancellations may not lawfully be effected by burying them in a massive, blanket set of cancellations. The law should not be so easily flouted. The I.C.C. should not stand idly by while this is happening.

Those railroads which have been cancelling rates and routes and closing gateways on such a massive basis are flouting the policy and requirements of the Staggers Act that there be healthy and vigourous transportation competition between and among the railroads. In the Procompetitive Committee's view, Congress never intended the Staggers Act to be used as a vehicle to enable railroads to insulate themselves from the competition of other railroads and deprive the shipping public of the benefit of intramodel competition within the railroad industry.

There is another aspect of the anti-competitive program of cancelling joint rates and through routes, closing gateways and terminating reciprocal switching arrangements. The railroads which formerly provided competitive service are being eliminated in the competitive transportation marketplace. Undoubtedly the Subcommittee will be receiving testimony from these railroads, some of whom are regional carriers and many of whom are short-line railroads. The non-participation in joint rates and routes forced upon these smaller regional and short-line railroads causes serious injury to them and to the shippers and receivers who have issued and desire to continue to use their services on a competitive basis.

This disturbing, anticompetitive trend is occurring at the very time, as pointed out in our Position Paper, that there has occurred an unprecedented merging of individual railroads into powerful rail systems. In addition to Conrail, the Burlington Northern, the CSX, the Norfolk Southern and the Union Pacific-Missouri Pacific come immediately to mind.

There are many ways that such cancellations suppress or undermine inter-railroad competition such as: cancellation of joint rates and through routes where the cancelling carrier can serve the origin and destination points directly or through switching carriers; cancellation of joint rates and through routes on movements which include a bridge carrier where the shipments would be transported by a competing route; cancellation of reciprocal switching where a joint rate and through route had been cancelled by a competing railroad and prior to the cancellation the switching railroad had participated in the joint movement; cancellation of reciprocal switching when a joint published tariff rate participated in by the cancelling railroad is higher than a single line tariff rate; artificial increases of minimum switching charges where the switching charge is absorbed in whole or in part by a line-haul railroad for the purpose of eliminating that line-haul carrier as a competitive alternative to the switching railroad; artificial increases where the switching charge is not absorbed in whole or in part by line haul carriers for the purpose of eliminating line-haul carriers as competitive alternatives.

Alarmed at this growing anticompetitive force in the economy, The National Industrial Transportation League on February 25, 1983, filed a Petition asking the I.C.C. to institute a rulemaking proceeding for the purpose of issuing rules to:

(1) Prohibit anticompetitive railroad cancellations of joint rates and through routes, and the closing of gateways; and

(2) Implement the procompetitive provisions of the Staggers Rail Act of 1980 pertaining to reciprocal switching arrangements and joint use of terminal facilities, through trackage rights or otherwise.

That petition of the League was denied by the Commission by Decision served July 7, 1983. Again the effort of shippers were unsuccessful in seeking to persuade the Commission to take a hard look at the anti-competitive aspects of these widespread and growing cancellations of joint rates and routes and related actions of the railroads. The Commission unwilling to act or is uninterested in doing so, in sharp contrast to its actions in the railroad revenue adequacy area.

Section 223 of the Staggers Act, now found in 49 U.S.C. § 11103(c), made specific provision, encouraging reciprocal switching agreements where such are necessary to provide competitive rail service. In *Universal Forest Products, Inc.* v. *Seaboard Coast Line Railroad Company,* served June 23, 1983, the Commission, Division 1, reversed a Decision of its Review Board No. 1 and denied the requested reciprocal switching arrangement. Among other things, the Commission Decision stated: ". . . It would be improper to allow a shipper to force the carriers into such an agreement under a little used provision of the Act." [49 U.S.C. § 11103(c)]. The Commission Decision here again is disregarding the objectives of the Staggers Act to encourage and strengthen genuine and vigorous competition between and among the railroads.

We mention this case primarily as another illustration of the Commission's attitude in failing to concern itself with achieving the objective of the Staggers Act to promote and to strengthen inter-railroad competition. We firmly believe that clarifying statutory language is needed to ensure that a major purpose of the Staggers Act is realized. The preservation of inter-railroad competition should not be left to chance, depending upon the make-up from time-to-time of the Commission. The obligation in this area must be set forth so clearly that it will be observed, regardless of who is serving on the I.C.C. at a given period of time.

It is the view of the Procompetitive Committee that the Interstate Commerce Commission is not applying the law in accordance with the Staggers Act. This misinterpretation of Congressional intent must be remedied. Otherwise, shippers will be denied the benefits of the Staggers Act which they had every reason to expect (and which they need) in terms of the law which Congress passed.

Passage of the Staggers Act came only after extensive and careful balancing by the Congress of the interests not only of the railroads but of the shippers and the public as well. This is emphasized in one of the specifically stated goals in Section 3 of the law:

"To provide a regulatory process that balances the needs of carriers, shippers, and the public."

It is a gross and harmful distortion of the Staggers Act for anyone to limit himself to concern with revenue need of the railroads while at the very same time ignoring the need of shippers for genuinely effective inter-railroad competition.

The Procompetitive Committee is not seeking re-regulation or new laws as such. Rather, in view of the positions being taken by the Interstate Commerce Commission, clarifying legislation to insure the attainment of the inter-railroad competition objectives of the Staggers Rail Act is necessary. This is aimed at requiring the Interstate Commerce Commission to administer the Staggers Act in the manner intended by the Congress.

There are remedies which can be employed by the Congress now to meet this challenge and to counteract the current developments which are reducing the marketplace choices of rail customers. These include: clarifying legislation, (1) prohibiting cancellation of joint rates and through routes, reciporcal switching arrangements or closing gateways where the purpose or result of the cancellation is inherently anti-competitive; (2) requiring observance and implementation of those procompetitive provisions of the Staggers Act aimed at encouraging the use of reciprocal switching to promote competition and aimed at easing the regulatory burdens on the extension or construction of rail lines; (3) confirming the purpose of existing law to facilitate a shipper's access to competitive rail services; (4) reaffirming the dedication of Congress to a market-disciplined rail industry.

The Procompetitive Committee is looking forward to working with you and your Subcommittee in developing legislative language where needed to accomplish its goal of improving and strengthening inter-railroad competition which will permit the economies of large rail systems to be attained under fair competitive conditions and will minimize regulatory interference.

The Procompetitive Committee is extremely concerned about the accelerated reduction in inter-railroad competition and the resultant injury this reduction is inflicting and will inflict on the nation's shippers and consumers. We are firmly dedicated to competition and marketplace forces as the best regulator of railroad service. Although it is apparent that Congress intended that the Staggers Act promote competition within the rail industry, we are convinced that clarifying amendments to the Act are required to realize Congressional intent and to restore, maintain and promote inter-railroad competition.

CONCLUSION

In our judgment, the Staggers Act was and is sound legislation. One of its most fundamental objectives, expressed repeatedly in the railroad transportation policy, is the achivement of vigorous inter-railroad competition. In this area, the Procompetitive Committee is convinced that the Interstate Commerce Commission, as presently constituted, has not been taking the action required under the Staggers Act to realize or to encourage vigorous inter-railroad competition. The Procompetitive Committee wishes to emphasize it is not seeking reregulation. Rather, clarifying statutory language should be enacted which will leave no doubt, in the minds of the I.C.C. or anyone else, that the Staggers Act objective of vigorous inter-railroad competition must be achieved.

We thank you for this opportunity to present this testimony.

POSITION PAPER BY PROCOMPETITIVE RAIL STEERING COMMITTEE

BACKGROUND

The United State's railroad system is the only surviving private-sector system in the world. Despite persistent financial problems in some sectors, this system has performed quite well over the years. U.S. railraods have operated as a cohesive, integrated transportation network facilitating the movement of the nation's commerce to and from all parts of the country—whether they be remote rural areas or the industrial heartlands.

The key to the success of this integrated network has been the railroads' maintenance of one factor, through charges consisting of a single freight rate assessed for the total movement from origin to destination, regardless of the number of railroads involved.

This pricing system generally referred to as "joint rates and routes", is analogous to domestic telephone service which permits customers to place a phone call from New York to California at a single, through charge despite the number of individual phone companies used in the communications network.

Like phone service, this system of joint rates and routes is critical to U.S. industrial operations, since roughly 66 percent of the rail industry's revenues are generated by shipments moving over the lines of two or more carriers.

The Staggers Rail Act of 1980 was the culmination of a lengthy joint effort by the Congress, the Administration, the railroad industry, and individual shippers and their organizations. This effort's objective was to reduce government interference in railroad managerial discretion. Its basic tenet was that the competitive marketplace should serve as the regulator of rail services wherever possible, and regulation should be limited to those areas where competitive forces were inadequate to the task, that is, in situations of market dominance.

Our experience under deregulation has been quite satisfactory in those instances where interrailroad competition exists. However, we are deeply concerned by the recent actions of major railroads which are designed to eliminate or radically reduce this type of competition because these actions serve to thwart the goals of a market-regulated rail industry.

Concurrent with the government's deregulation efforts, there has been an unprecedented merging of individual railroads into massive rail systems. In 1976, the six bankrupt eastern railroads were combined into the huge government-supported Conrail system. During the past three years, this merger movement has accelerated and resulted in the formation of such mammoth rail systems as the Burlington Northern, the CSX (Chessie System and Seaboard System), the Norfolk Southern, and the Union Pacific—Missouri Pacific.

This merger activity is not likely to abate. Indications are that, within the next few years, the U.S. rail network will consist of three or four dominant rail systems buttressed by small regional and local feeder lines. Ensuring effective competition among a declining number of major railroads will be one of the market-disciplined, rather than extensively regulated, rail industry.

ISSUES

Joint rates and routes

Recently, ominous developments have occurred which have seriously reduced the level of inter-railroad competition. A number of dominant rail lines have embarked upon a program of eliminating or restricting the availability of joint rates and routes. These actions, aimed at restricting joint movements, have been without regard to the relative efficiency of the closed routes or the impact on rail shippers. In many cases, these railroads are refusing to participate in competitive joint service, and are insisting upon the right to provide exclusive service to all origin and destination points located on their tracks.

Joint rate and route cancellations have spread like prairie fire, and have reached the stage of internecine warfare. This warfare is spreading because the Interstate Commerce Commission has refused to interfere with the foreclosure of competing railroads' ability to provide service to interested rail shippers.

This trend has had an adverse impact on the financial stability of smaller railroads, their employees, and the communities they serve.

If permitted to continue, this trend will result in even futher reductions in inter-railroad competition. The refusal of some railroads to deal fairly with competing connecting lines threatens to destroy the joint rate and route system which is so critical to the free flow of the nation's commerce. The threat of Balkanization of markets becomes more real with each new announcement of route closings and cancellations. Rail shippers served only by one railroad may ultimately be economically constrained to regional markets or to distant customers located on the origin railroad.

Competitive access

A truly competitive railroad industry would provide a shipper with access to two or more rail choices. Unless a shipper can choose from among a variety of rail services, his leverage in the marketplace is undermined, and the forces of competition are stymied. When a shipper is forced to do business with only one railroad, his negotiating leverage is limited to external sources—to the extent they are available—such as competition from other transportation modes, or the losss of a market due to non-competitive transportation pricing.

These alternative market pressures do not operate as a guarantee that monopoly profits and costs will be eliminated from rail pricing, because, in many instances, competing mode costs are unrelated to, and do not serve as a brake on, rail costs. Unfettered, direct rail competition is the only practical way of ensuring distribution of the benefits of rail pricing based on the true economic costs of this transportation. A truly competitive rail system requires that the shipping public be assured of access to those carriers willing to serve their commercial needs.

Although the Staggers Rail Act had among its goals the fostering of inter-railroad competition, and provided such procompetitive mechanisms as reciprocal switching and eased approval procedures for the construction or extension of lines, this Congressional objective has yet to be realized. The past few years have seen substantial reductions in competition. In addition to the joint rate and route cancellations and mergers, some carriers have reduced competition through manipulation of reciprocal switching rights.

For example, some railroads have canceled longstanding agreements for reciprocal switching services despite the fact that their compensation for these service was adequate. Others have set the charge for this service at such a level that it is no longer commercially feasible for rail shippers to use this service. Others have refused to enter into agreements because of their desire for continued domination of the traffic which would be affected by a switching agreement. Shippers have built businesses and distribution systems around such services with the reasonable expectation that they would continue to be available.

Ideally, a shipper should have access to as many railroads as can practically compete for his business. Physical access can be provided by a variety of mechanisms including:

A grant of "trackage rights" to interested carriers not having tracks serving a shipper's facilities. This mechanism would allow a railroad to operate over the tracks owned by another rail line in exchange for a fee covering costs and reasonable profit.

Extension or construction of tracks to allow a railroad to reach the facilities of a shipper currently "captive" to another railroad.

Joint ownership of terminal facilities in those areas served by two or more railroads, so that interested carriers would have access to the facilities of the area's shippers.

Where physical access is not feasible, for whatever reason, other mechanisms can be employed to achieve the same competitive objective. These mechanisms include:

A grant of "reciprocal switching" rights where one carrier provides pick up or delivery service in a terminal area for another carrier providing the line-haul service. In exchange for this service, the line-haul carrier pays a charge covering service costs plus reasonable profit.

The establishment of a rate or rates between a shipping facility and a selected interchange point or points where competing rail service is available. These rates should cover a carrier's service cost plus reasonable profit.

POSITION

The Procompetitive Rail Steering Committee is extremely concerned about the accelerating reduction in inter-railroad competition, and the resultant injury this reduction will have on the nation's shippers and consumers.

Members of this committee represent industries that are tied to the railroads by production facilities designed for rail service and distribution systems geared to long-distance, high-volume shipments, which generally are not adaptable to transportation by truck or intermodal service. Changing our dependence on rail service could not be accomplished without massive capital infusions and unacceptably high increases in operating costs. We are vitally interested in the maintenance of a financially healthy, market-disciplined rail system adequate to move the nation's commerce and support the nation's defense needs.

The committee remains firmly dedicated to competition and marketplace forces as the best regulator of railroad service. Although it is apparent that Congress intended that the Staggers Rail Act promote competition within the rail industry, the committee is convinced that clarifying amendments to the Act are required to realize Congressional intent and to restore, maintain, and promote inter-railroad competition.

The committee plans to develop, draft, and seek support for legislative language that will ensure this type of competition, and will permit the economies of large rail systems to be attained under fair competitive conditions that will minimize regulatory interference.

Senator **Danforth**. Thank you, Mr. Wilkins. Mr. Burdakin.

Mr. **Burdakin**. Good morning, sir. My name is John Burdakin. I am president of the Grand Trunk Corp., which controls four railroads, relatively is small in regard to the large carriers that are existing through the merger scene that is going on today, but, on the other hand, rather substantial pieces of property, with 5,000 employees.

I am here not only for myself but I am here also to represent a number of small railroads, all of which are represented here behind me, and I will not take the time to introduce them. But they, too, combined are deeply concerned at the direction in which we are going, under what we interpret of the ICC's application of the Staggers Act that is not as designed and intended to by Congress.

I have prepared a formal statement, which is here, and there are copies for everybody. In addition to that, there are statements from executives of other railroads—the Green Bay & Western, the SOO, the Pittsburgh, and Lake Erie—as well as an appendix showing some examples of what we are talking about.

Our concern is the closing of routes and rates that has taken place, and included in this is the reciprocal switching activity that has gone on primarily by Conrail. In one fell swoop, Conrail on one piece of paper closed off over 100,000 different routes in which many of these small carriers, which, as I say, are geographically located throughout the country, had those routes closed off and they can no longer participate.

We are also watching other systems, who having realized that Conrail can do this with no retaliation or explanation required in front of the Commission are taking similar actions. So this is an area in which the bigger ones are closing off the routes and the gateways which are open to and have been through history open to small carriers and open to shippers.

This was taken to the Seventh Circuit Court, who in turn termed the action of Conrail as being a meat axe approach and was not what was contemplated in the Staggers Act and remanded it months ago back to the Commission. In spite of urging, et cetera, the Commission has taken no action on this remand. It has no hearing scheduled.

And the result of that is that the actions are still in effect. The small carriers are still being shut off from the competitive opportunities and suffering as a result of it.

In regard to reciprocal switching, of which there are examples in the prepared statement, Conrail has put a charge on reciprocal switching which makes it impossible for small carriers who have limited line haul to be able to pay the charge that Conrail has set.

In 1980, that charge was in the area of $60 to $90. In 1981, they put it up to $181, and it currently is at $283. And by their own statements they are reviewing that switching charge and obviously not with the idea of lowering it. Even they admit that this is well over 100 percent above their costs in that switching charge, and by our cost analysis we are in the area of about 230 percent over the cost. What this has done is close us off.

The smaller carriers, as I say, are suffering very severely as a result of these actions. We think that is a misinterpretation of what the Congress intended the Staggers Act to be and what it intended to do in maintaining and competing in a competitive network within United States.

Unfortunately, the small railroads are all part of it. We are all part of keeping the competitive edge against the large carriers, but we are being closed off because of the activity that is going on in the interpretation.

So let me say that we are concerned about this. We are concerned about our welfare to the point that we may not be around much longer, some of us, anyway, if these are allowed to continue on to adversely affect us. These big carriers just arbitrarily are taking away our opportunity to enjoy traffic that we have over the years and to remain competitive.

I appreciate the opportunity to represent these railroads here before you this morning, and we do hope that somewhere in the near future there will be a change in thought of how to keep the competitive aspects of our rail system in the United States.

Thank you.

[The statements follow:]

STATEMENT OF JOHN H. BURDAKIN, PRESIDENT, GRAND TRUNK SYSTEM

My name is John H. Burdakin. I am President of the Grand Trunk Rail System. I appreciate this opportunity to present you some smaller railroads' review of their first two years of experience under the Staggers Rail Act (SRA). It has been a deeply disturbing experience, as I will show you through this statement.

At the outset, let me tell you about the companies I represent and where they fit into the Committee's area of responsibility. As President of Grand Trunk Rail System I am directly concerned about implementation of the Staggers Act as it affects the following railroads making up that system: Central Vermont Railway, Inc.; Detroit, Toledo and Ironton Railroad Company; Duluth, Winnipeg and Pacific Railway Company; and Grand Trunk Western Railroad Company. Grand Trunk and DT&I are Class I railroads, and CV and DWP are Class II carriers.

However, I appear here today speaking for a more extensive of small railroads who have become so concerned about the Commission's free-wheeling implementation of the joint rate cancellation provision of the Staggers Act that we have joined together in a common effort to try and do something about it before it is too late.

Our group is made up of the carriers listed in Appendix A to this statement. Some of them, including Grand Trunk, are small Class I's but it also includes Class II and Class III railroads. All of them harbor deep fears about the manner in which the Commission is implementing (or failing to implement) the joint rate provisions of SRA.

One of our major problems has been and is the difficulty we have had in trying to get someone to be concerned enough to really examine what has been happening in the area of joint rate cancellations and route closings. We are encouraged by these hearings and urge the Committee also to become alarmed by what is happening and to take the matter in hand—again before it is too late.

As to what needs to be done I must tell you that the Act must be significantly tightened, and its administration must be carefully monitored, or some smaller railroads (like those in our group) may not exist by the time of your next oversight hearings. The rate setting and route closing freedoms set out broadly in the Act are being misused in massive fashion to create predatory practices which the Congress could never have conceived—indeed, practices which I believe Congress expressly attempted to preclude. Loopholes exist in this new law which are being abused to create a climate where more railroads can be forced into the same straits where Conrail has languished for the past ten years.

As you know, the nation's medium and smaller railroads hae played a vital part in the nation's rail transportation system since the earliest days of railroading in this country. When Congress concluded, both in the 4R Act of 1976 and in SRA, that more competition was needed in the rail industry, these railroads generally agreed and for that reason supported the goals of these important pieces of legislation. We continue to believe today that there is an important role for the nation's smaller railroads to play in the more competitive rail system of the future.

However, we see the actions of the Commission as not only causing disproportionate harm to smaller carriers, but as endangering their revenues and even their existence in the future. If allowed to go unchecked, current trends will foster a noncompetitive system of giant railroads, each dominant in a section of the country and facing no meaningful rail competition in its own territory. That is emphatically not a result Congress intended in 1980.

The problem, to put it briefly, is route closings. Typically in rail transportation, competition between any two points is provided by a series of different routing alternatives, and in many instances by competition from other transportation modes as well. In this regard I commend to your attention the graphic examples provided by some small railroads in our group that are shown in the Appendices to my statement. They demonstrate naked abuse of market power by large carriers against smaller ones. They show beyond doubt that smaller carriers, shippers, and competition generally have suffered at the hands of large carriers effectuating anti-competitive joint rate cancellations and route closings.

The classic example is, of course, the Conrail closing of over 100,000 through routes in one fell swoop which the Commission blithely approved in its Docket No. 38676. By removing from the basic routing guides almost all routes except Conrail's longest haul routes on interterritorial freight traffic, Conrail effectively cancelled almost all through routes the Grand Trunk previously possessed with it to handle traffic (between Chicago and Buffalo, for example) destined to and from Conrail served industries in the East. Conrail is in a position to exercise tremendous monopoly power because at nearly 3,000 stations throughout the Northeast it is the only railroad serving industries located at those stations. Conrail has chosen to exploit that position by restricting the shipper's routing alternatives to and from these points.

For example, many shippers routed their traffic GTW east of Chicago (to Buffalo thence Conrail to destination) in order to get the expedited service which we produce. The shipper always had the right to route via Conrail all the way east of Chicago. But because Conrail was unable or unwilling to provide satisfactory service, the shippers often favored us with the routing to intermediate points such as Buffalo and Detroit. These routes have existed for many years, and provided the basis for extensive competition among railroads for "overhead" traffic (traffic moving between points which the handling railroad does not serve). Seattle to Boston traffic, for example, is overhead traffic to GTW, since we can handle it only between Chicago and Buffalo—if the routes are open and if the shipper prefers our service. By cancelling all of these routing guide routes, Conrail took away the shipper's right to designate GTW service on such transcontinental traffic.

More importantly to us, it took away our right to compete for such traffic. The dismal irony of this elimination of our right to compete was that it was proposed and approved by the Commission under SRA—an Act of Congress we all heralded as procompetitive legislation.

In vacating the Commission's order in this case and remanding it for further hearing on the adequacy of Conrail's evidence, the Court of Appeals for the 7th Circuit observed that nothing in the record before it excludes the possibility that "a meat-ax approach was taken" in this massive cancellation of competitive routes.[1]

I mention this because it is a typical example of the failure of the Commission to do its job in implementing the Staggers Rail Act. It simply does not appear to care enough to look carefully at severe adverse harm being done to small railroads.

Most small railroads are also stunned by the growing number of rate actions by large carriers refusing to participate in any competitive joint rate between an origin and destination point both of which are served by the large carrier. Here again, regardless of any considerations of efficiency or competition, small railroads are being denied the right to compete by having their joint rates over competitive routes cancelled. Conrail, Burlington Northern, Southern Pacific, and others have taken such anticompetitive actions while the Commission blandly looks on.

I ask you: did Congress really intend such anticompetitive actions to be countenanced when it enacted the procompetitive Staggers Rail Act? What public interest concept is served by allowing such large companies to guarantee their own single line long haul by refusing to participate in competitive joint rates with smaller intermediate carriers?

The competitive balance that exists can be upset in various ways. One type of route closing is where Carrier 1 reduced a single-line rate (between A and C), but refuses to make an adjustment in a competing joint rate in which it participates. In that instance, and since Carrier 2 is unable to reach between the two end points of the market (A to C) by itself, the joint rate will remain at a higher level and will close the joint-line route by rendering it noncompetitive. Another type of closing is where Carrier 1 cancels its participation in the competitive joint rate, allowing to be substituted for it proportional rates which when taken together are not competitive with the single-line rate. A third way is simply to raise a proportional rate on a joint-line route to a point where that route will no longer be competitive with the single-line route. A variation of this latter approach is for a carrier which serves an industry which is open to reciprocal switching to eliminate the competition by unilaterally increasing the reciprocal switching charge applicable to that industry to a level which forces the shipper to route only via the serving carrier.

All of these measures have one thing in common: they eliminate joint-line competition with single-line routes. If railroad transportation were a more perfect market, where connecting carriers (such as Carrier 2 in the example above) could serve the entire market (A to C) by themselves, this pattern of single-line reductions, joint rate cancellations, and proportional rate adjustments could be tolerated and perhaps even encouraged. But that is not the reality of the railroad industry. The fact is that where carriers having both single-line and joint-line service between the same points take action that is harmful to the joint-line alternative, that line ceases to function as a competitor in the market.

If the joint route is demonstrably and significantly the less efficient route, we do not argue with the proposition that it should be closed. However, what is happening today is that many joint routes that are fully competitive from the standpoint of efficiency are being closed simply because the carrier with the single-line competition is being allowed to close them effectively at will. There is not even any guarantee under the procedures being followed by the ICC today that joint routes that are more efficient than competing single-line routes will not be close.

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[1] *Chesapeake and Ohio Railway Co. et al* v. *United States,* 704 F. 2d 373, slip copy, p. 9 (decided Apr. 4, 1983).

Beginning in the so-called "Family Lines," case [2], the Commission allowed a large number of joint rate cancellations to go into effect without investigation or suspenson. This immediately foreclosed the significant routing options, all without even the opportunity for shippers or other railroads to demonstrate that joint-line routing options were as efficient as the competing single-line routes. In a number of subsequent cases, many involving actions of Conrail, the Commission has allowed the same result. All of these actions have substantially lessened competition by substantially lessening the available routes. In the imperfect market which is railroad transportation, preservation of routes is the only way that carriers that do not serve the entire route can provide competition.

We have been in the midst of a deep recession, which has affected many railroads severely. Much equipment lies idle, and it has generally been a buyer's market in transportation services. In such circumstances, the full effects of route closings cannot be felt—shippers for the most part are still being served, and transportation prices are generally lower. However, as the economy improves, when demand for service is tight and prices are rising, shippers will feel the full impact of route closings and other anticompetitive actions. By then, if competitive joint routes have been eliminated and the financial condition of smaller carriers has been weakened, it will be too late to restore competition to the nation's rail system.

An argument that is sometimes raised against our position here is that intermodal competition mandates single-line reductions and joint-rate cancellations, and that joint-line routing is uneconomical and impractical in today's highly competitive transportation environment. Our response is that this is no excuse to do away with intramodal competition. In the case of single-line reductions, smaller carriers should be given the option of competing on joint-line routes at the reduced rate levels. In some cases, they will not wish to do so anyway, but they should be given the chance in the interest of preserving and promoting competition overall.

In the case of joint-rate cancellations, the justification of intermodal competition is not convincing, since frequently no single-line reductions accompany such a move. Here again, there are many instances where overall competition is the loser, and such actions shouldn't be allowed where that is the case. The purpose of the Staggers Act is not to fatten the pockets of larger carriers at the expense of other carriers, but rather to enhance competition among all carriers.

Finally, in many cases there is no meaningful intermodal competition. In some situations, shippers' options consist only of rail options. In these cases, the importance of intramodal competition is even more evident, since the alternative is monopolization of routes, more market dominance, more maximum rate regulation, more regulation, period. No one wants this to happen, and the time is now to ensure that it doesn't.

The Commission's attitude toward route closings is not only contrary to sound policy and Congress' generalized intent to promote rail competition. More specifically, it is also contrary to Congress' purposes in the enactment of Section 217 of the Staggers Act, which involves joint rate cancellations and surcharges. That section, as you know, represents a detailed and painstaking compromise between competing interests concerned about route closings and rail competition. By adopting the course it has taken; namely, allowing massive route closings by refusing to investigate and suspend them under Section 10705(e) (the pre-existing section of the Interstate Commerce Act dealing with joint rates and routes), the Commission has thrown the Section 217 compromise right out the window. Now, under prevailing Commission practices, it is much easier to close a route even though the closing carrier's revenue-to-variable cost ratio over the joint route is far higher than Congress intended it to be under Section 217, where the revenue-to-variable cost ratio must be at or near variable cost. This is a complete subversion of Congressional intent, and, as we have seen, has had highly damaging impacts on smaller carriers as well as competition generally. Nor is there any evidence that the Commission has seen the error of its ways or that it will not continue to do what it has been doing.

It would perhaps be comforting to think, as some have suggested, that the antitrust laws provide an adequate remedy for anticompetitive route closings. However, we do not believe that the antitrust laws provide the answer to this problem. While the most serious cases of route closings might give rise to actions alleging monopolization or restraint of trade, the antitrust laws cannot prevent the action from occurring in the first instance, particularly since the Commission has given active support to these route closings. Even assuming that an injured carrier or shipper can sue and collect damages under the antitrust laws, the harm to the rail system will have already occurred. And it is the system that must be preserved now.

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[2] Family Lines Rail System—Unilateral Cancellation of Joint Rates, 365 I.C.C. 464 (1981, 365 I.C.C. 569 (1982) aff'd sub nom., *Southern Ry. Co.* I.C.C., 681 F 2d 29 (DC Cir. 1982).

The Commission seems to have forgotten that the Congressional purpose behind deregulation was to foster competition, and that regulation should be maintained where to do otherwise would lead to monopolization or other anticompetitive results. The Commission's mandate was not and is not to deregulate for the sake of deregulating. Congress clearly expressed its intent to keep regulatory mechanisms in place where needed, and in the railroad industry there are such instances. Accordingly, to fully implement the Congressional intent of the Staggers Act to promote competition in the rail industry, we believe that a relatively minor legislative change is necessary to put the Commission on the right path towards these goals. In our view, such legislation would contain the following elements:

(1) A provision allowing the restoration of rail competition in cases where a major carrier effects a single-line rate reduction without concurring in a reduction of the competing joint-line rate. Essentially, this provision, which we call the "Independent Rate Authority", would enable the connecting carrier on the joint-line route to publish a joint-line rate level over the entire route that is competitive with the reduced single-line route provided the rate is profitable to all the participating carriers. This will keep the routes competitive with each other, without losing the competitive benefit of allowing the major carrier to effectuate a rate reduction in the first place. The Commission would continue to have authority to investigate and suspend the rate changes involved, but would not be permitted to investigate or suspend one change and not the other.

(2) A provision indicating that suspension and investigation of joint rate cancellations under 49 U.S.C. 10705(e) is mandatory. Too often, the Commission has simply allowed massive route closings to take effect by the simple device of refusing to investigate and suspend under this section, which now allows the Commission full discretion in the matter. We believe that the Commission has abused that discretion, and that it should no longer have it. When investigation and suspension is denied in these cases, there is nothing preventing fully competitive joint-line routes from being eliminated without a trace. This must not be allowed to continue.

(3) A provision revising the standards of 49 U.S.C. 10705(e), under which the Commission would have to consider any reduction in intramodal competition and any evidence that such cancellation would unreasonably restrain trade, lead to monopolization, or otherwise be anticompetitive, predatory, or designed to eliminate competition from smaller carriers. While such a provision might be unnecessary if the Commission were properly applying present law, the fact is that a more specific directive is needed at this time.

(4) A provision allowing smaller carriers to open up viable joint routes that are competitive with single-line routes, but where the larger carrier does not wish to make the joint-line route competitive. This is a matter of some concern since often the smaller carrier is efficient, lower-cost than the larger carrier, and capable of contributing substantially to competition if only it can participate competitively in a joint route. In many cases, this provision would enable restoration of joint-line competition in a case where it has recently been eliminated by route closings.

(5) A provision redefining the standards of the so-called Lee Amendment (49 U.S.C. 10705a(i)) to make them more specific, since the Commission has failed to implement the Lee Amendment in a way that affords any realistic protections for Class III carriers. Also, since the damage in this area is also being done to Class II and smaller Class I railroads, these protections would be expanded to cover those railroads as well. In addition, procedural protections under Section 10705a are needed, including proper notification of connecting carriers of surcharges and cancellations and a shift in the burden of furnishing variable costs and revenues to the surcharging or cancelling carrier.

A copy of our draft legislation, which is entitled the "Rail Competition Act of 1983", is being submitted to the Subcommittee for your consideration. We are not committed to our proposal in its present form as being the final answer on this subject, and we are aware that there are other groups that are working on legislation intended to bring about the same or similar results. We are willing and ready to cooperate with the Subcommittee and its staff to consider this matter as you may wish.

To sum up, let me say what I think may be in store for the nation's rail system if something is not done about this problem. Because of the threat of route closings and other retaliatory actions by larger carriers, smaller carriers have already had to weigh their actions carefully for fear of unleashing forces beyond their control. This subservience, whether based on actual or potential threats, is not consistent with the competitive vigor needed on the part of all carriers to make the Staggers

Act work. The threat of route closings is leverage against smaller carriers that can intimidate them in dozens of different ways. This in turn can lead to the erosion of the assets of those carriers, the breakdown of service to their shippers, and nonopolization and other anticompetitive impacts. That could lead to further concentration in the industry. All of these factors could present Congress with the prospect of major new railroad legislation at some future time to protect the public interest, not just a minor remedy to preserve and promote competition now.

On the other hand, if competitive joint routes and the role of smaller carriers are preserved, we see a future in which competition can work to the benefit of everyone, including larger carriers, smaller carriers, and shippers. With a fair opportunity to compete, smaller carriers can act as equals in the interplay of competitive forces that will bring about a more effective transportation system for the nation, as well as a more effective implementation of the Staggers Act.

Thank you for this opportunity to appear before the Subcommittee. If you have any questions at this time, I will be glad to try and answer them.

RAILROADS PARTICIPATING IN SMALL RAILROADS JOINT RATE CANCELLATION TESTIMONY

Bassemer & Lake Erie Railroad Company (and affiliated railroads).

Grand Trunk System Railroads: Central Vermont Railway Inc.; Detroit, Toledo and Ironton Railroad Company; Duluth, Winnipeg & Pacific Railway; Grand Trunk Western Railroad Company.

Green Bay and Western Railroad Company.

Kansas City Southern Railway Company.

McCloud River Railroad.

Pittsburgh & Lake Erie Railroad.

Sandersville Railroad Company.

Soo Line Railroad Company.

Appendix

A. SEABOARD SYSTEM RAILROAD CLOSING OF LOUISVILLE GATEWAY

The Milwaukee Road obtained access to Louisville, Kentucky by virtue of a finding by the Interstate Commerce Commission that shippers should have a routing alternative to that offered over Chicago by the former Seaboard Coast Line and Louisville and Nashville Railroads when they came under the common control of what is now known as the Seaboard System Railroad, Inc., which in turn is part of the mammoth CSX System. Milwaukee Road offered routing alternatives for shippers captive to the Seaboard in the South (known as the Southern Freight Assocation Territory) for movement to and from the western and far western states (known as the Western Trunk Line Territory and the Trans-Continental Freight Bureau Territory).

Although Seaboard preferred its long haul routing via Chicago, shippers in many cases routed the traffic via Milwaukee Road at Louisville to Chicago and beyond for connection with western carriers to points beyond Milwaukee's service area. In these instances, Milwaukee Road's presence at Louisville served as a competitive spur to the Seaboard and the giant carriers in the West which could be short hauled by shippers' inclusion of Milwaukee in the routing.

However, as soon as the Commission gave the signal that it was no longer going to preserve competitive routing alternatives, Seaboard decided that route closings, rather than competition, served its interests best. In January of this year, Seaboard used the meat axe approach to eliminating routes by publishing supplements to the routing guide tariffs applicable to traffic moving between the Southern Freight Association Territory, on the one hand, and either the Western Trunk Line Territory or the Trans-Continental Freight Bureau Territory, on the other hand. (Blanket Supplement 411 to a Series of WTL rate tariffs and Supplement 124 to ICC TCFB 1014-B and other rate tariffs. The effect of these tariffs was to restrict shippers from routing tariff via short haul gateways served by Seaboard. Since Seaboard served both Chicago and Louisville, it thereby refused to participate in shipper routing of traffic through Chicago to Louisville unless it received the traffic at Chicago. So much for Milwaukee as a competitive spur.

Milwaukee Road protested these actions before the Commission, requesting that the tariffs be suspended and investigated. (I&S Docket Nos. 70998 and 70998-2) Seaboard made no attempt to show that the cancelled routes were non-compensatory. The Commission voted not to suspend or to investigate.

B. CONRAIL'S EXORBITANT PRICING OF RECIPROCAL SWITCHING CLOSES ROUTES

Conrail serves thousands of industries throughout the Northeast and Midwest exclusively where it can exercise tremendous leverage over the shipper to route the traffic via its long haul. However, some of these points are "open" to reciprocal switching, which gives the shipper the ability to route the traffic via another carrier that has trackage in the vicinity. Neverthless, a shipper normally wants to give its serving carrier a road haul movement, and the reciprocal switch to another competing carrier is used only under extraordinary circumstances or when the serving carrier refuses or is unable to offer reliable, competitive service. The Staggers Act recognized the pro-competitive potential of reciprocal switching by adding a new provision making it easier to open new stations to this service.

Conrail in the early 1980's found that it was selling on a net basis a lot more reciprocal switching services than it was buying, i.e. shippers served directly by Conrail were choosing to a greater degree to route traffic via competing carriers while giving Conrail only a switch than were shippers located on the lines of Conrail's competitors. Rather than improving service or reducing prices, Conrail chose to discourage the use of reciprocal switching by raising the price for that service to exorbitant levels.

In the Spring of 1981 Conrail doubled the price of reciprocal switching to $177 per car. While some carriers attempted to fight the increase at the Commission, the increase was permitted to go into effect. Most competing carriers, including Grand Trunk, decided to pay the higher charge from their portion of the revenue received from the road haul freight charge, thereby putting a squeeze on the profitablity of these carriers. Shippers continued to route traffic by Conrail's competitors while giving Conrail only a switch.

Conrail decided to tighten the cinch on the noose around its competitors' necks in March of this year when it again raised the reciprocal switching charge to $283 per car. Grand Trunk protested this action at the ICC, and offered expert testimony showing that using Conrail's own cost figures it would receive a 226 percent revenue to variable cost return on each switch it performed at this new rate. Conrail's rebuttal conceded that the rate of return was at least 197 percent of variable cost. The Commission in I&S Docket No. 71021-1 refused to suspend or investigate the new rate, and it went into effect on March 18.

At many points Grand Trunk simply cannot afford to absorb the stiff switching charge from its road haul freight revenue and cover its costs. The shipper which prefers Grand Trunk's service will no longer elect those routes because it would have to pay the additional charge. Therefore, traffic out of a General Motors plant in Grand Rapids, Michigan served by Conrail that once moved to Scarboro, Ontario via a reciprocal switch to Grand Trunk's more efficient route now moves nearly 70 miles out of route via Conrail to an interchange point with Grand Trunk at Battle Creek, Michigan.

Another major automotive plant at Lansing, Michigan is similarly affected. Conrail and Grand Trunk serve opposite ends of the facility, each of which produces different automotive parts for shipment east or west. Conrail has never been competitive with Grand Trunk on westbound traffic to major assembly plants in Kansas City, Arlington, Texas, St. Louis and Van Nuyes, California. The shipper routed traffic from Conrail's end of the facility via a reciprocal switch to Grand Trunk for the road haul movement to its gateway at Chicago or to Kansas City in conjunction with Milwaukee Road.

The new charge makes those movements extremely marginal to Grand Trunk, and it may be forced out of the routing by Grand Trunk's predatory action.

These instances demonstrate that the abuses permitted these giant carriers by the Interstate Commerce Commission contradict the goals Congress set in the Staggers Rail Act of 1980. This perversion of the Congressional mandate can only be stopped through specifically tailored refinements to the Act to close the loopholes which the ICC has created.

STATEMENT OF SOO LINE RAILROAD CO.

RAILROAD ROUTE CLOSINGS

The Soo Line Railroad Company has been the victim of a number of interline route closings, examples of which are described below. In all such cases, shippers and the public have been deprived of competitive rail shipping alternatives which have existed is most cases for many years. The route closings have been carried out by long haul carriers in an attempt to monopolize the freight traffic involved, a clear abuse of the intentions of Congress in passing the Staggers Rail Act of 1980.

Sulphur. From refineries and other origin points in North Dakota located on Burlington Nothern destined to Chicago for movement beyond to the east and southeastern United States. Historically, the Twin Cities gateway was opened permitting Soo Line to participate in movement of this traffic between Minneapolis and Chicago. Burlington Northern has now closed the Twin City gateway to this traffic forcing the shippers to use Burlington Northern exclusively to Chicago, at whatever rate level BN chooses to set.

Lumber From Burlington Northern origin points in the Pacific Northwest to the eastern and southeastern United States. Historically the Twin City gateway was opened to this traffic and permitted Soo line, Chicago and North Western, the Milwaukee Railroad and other Twin City carriers to compete for this traffic for part of the movement. Burlington Northern has now put in new rates applicable only to single-line movement to Chicago or other long haul BN junction points. BN has also closed the Twin City gateway by tariff cancellation and in other instances has made new joint rates with eastern connection without disclosure. All of these tactics produced the same result: BN will handle shipping only when it can obtain the longest possible haul, thus depriving shippers of numerous alternative routings involving various intermediate carriers.

Wrapping paper From long View, Washington to New England from a Burlington Northern origin point. This traffic formerly was routed Burlington Northern to the Twin Cities, then via the Soo Line to Sault Ste. Marie, Michigan, and from there via other carriers to destination. Burlington Northern simply closed the Twin City gateway, preventing the shipper from utilizing Soo Line in its routing, without reducing rates.

Fertilizer. From Ohio to Kent and Auburn, Washington. A routing formerly available and frequently used was Conrail to Chicago, Soo Line to the Twin Cities, and Burlington Northern to destination. BN cancelled all routings except those which give it the longest possible haul. This route concellation was filed in a general commodity tariff and therefore affects a broad range of commodities.

Corn. For export from Soo Line origin points in North Dakota and western Minnesota to the Pacific Northwest. Soo has no line of its own to the West Coast and therefore is dependent upon connections with transcontinental carriers. Burlington Northern Refused to allow a joint routing from any Soo origin stations, thus preventing shippers located on the Soo Line from gaining access to West Coast export markets. The same action was taken by BN on corn for domestic use in the Pacific Northwest, where most destinations are served by BN.

Grain. Gathering rates in North Dakota to eastern destinations. Historically, the Twin Cities have been a gateway for the movement of wheat from farm to mill. Rates have traditionally "broken" over the Twin Cities and grain traffic has been freely exchanged at that gateway for continued movement east. Burlington Northern has now closed this gateway, depriving shippers of the opportunity to route traffic via any of the three other trunk line carriers serving Minneapolis and St. Paul and threatening the historic grain rate structure.

STATEMENT OF CURTIS J. HOCKADAY, PRESIDENT, GREEN BAY & WESTERN RAILROAD

My name is Curtis J. Hockaday. I am President of the Green Bay & Western Railroad (GB&W). I have held this position with the GB&W for the past two years. Previous to that time, I was Asst. Vice-President of Katy Lines Railroad, and before that a Vice-President of Burlington Northern. Most of my railroad experience has been in the field of marketing.

GB&W is a Class II railroad with 250 miles of main line track extending from Winona on the West to Kewaunee, Wisconsin, on the East. GB&W provides efficient railroad transportation to shippers, communities, and members of the public in substantial portions of the State of Wisconsin. GB&W's traffic is reasonable balanced among originating, terminating, and bridge movements.

Shipments originating on the GB&W consist of sanitary paper; heavy paper; canned goods; sand; frozen vegetables; cheese, butter and dairy products; and a variety of other commodities. Originated traffic represented 42.8 percent of our total carload business in 1981. Inbound traffic for delivery on our line consists of lumber and building products, fertilizer, export grain products and food products. Terminated traffic represented 34.7 percent of our 1981 carload traffic. In addition, overhead traffic in 1981 represented 19.9 percent of the total carload business that year. Overhead traffic also consists of a wide variety of commodities including fabricated metals, clay, soda ash, fertilizer, lumber and building products, autos, various grain and grain products, salt and chemicals. Originating, terminating, and overhead traffic constitute 97.4 percent of our business which virtually all moves on joint rates.

Only 2.6 percent of our business in 1981 was single line or local traffic requiring another carrier's participation.

Our joint rate problems since the provisions of the Staggers Act became effective have been as wide and varied as the commodities and types of traffic which makes up our base. They have progressively become more damaging to the GB&W. Our freight revenues declined from $21,491,000 in fiscal year 1981 to $18,629,000 for fiscal year 1982, a drop of 13 percent. During the first five months of fiscal year 1983 they have continued to decline and are currently approximately 30 percent below the same period of last year. Of course there are other important causes of this decline but I am satisfied that cancellation of our joint rates is a major one. This decline is in spite of the fact that we have aggressively marketed our services through use of over 120 shipper-railroad contracts, most of which are designed to attract competitive traffic by granting the shipper special services or allowances.

A major blanket route closing action by Conrail undoubtedly caused some of this loss. Even though it was later made inapplicable to GB&W traffic, it had already been in effect due to the Commission's refusal to suspend, and our regular traffic patterns had been disrupted. For example, we have been unable to participate in some profitable plywood traffic to Long Island, N.Y., via Conrail—traffic we once had enjoyed.

We are no longer allowed to compete for soda ash traffic from Wyoming to the East because of Union Pacific's rate cancellations. The Burlington Northern has eliminated our right to compete for lumber traffic moving to the East from origin points on its lines by forcing it all to move via Chicago.

We have even been denied the right to compete for some traffic to and from points on our own 250 mile line. For example, synthetic plastic moving via Conrail from South Brunswick, N.J., destined for Green Bay, Wisconsin, our headquarters city, and canned goods from Plover, Wisconsin via Conrail to Salem and Woodstown, N.J. These actions, which will be discussed in more detail later in this statement, are a part of the pattern of the long haul railroads to force all traffic to remain on their lines to their preferred gateways. The result is a denial of our right to compete.

A large portion of our revenue is derived from our originating traffic. The basic problem we face daily is the refusal of Class I carriers to concur in the establishment of new joint rates. They simply refuse to concur in a proposed competitive rate over our route and leave us with a higher and noncompetitive "paper rate" over routes via our line. Despite the Staggers Act's emphasis on revenue to variable cost ratios, such relationships are not nearly the issue that maximum total revenue seems to be as a determining factor. We are being denied concurrences for participation in joint rates where the nonconcurring railroad's ratio is clearly profitable and in some cases exceeds the ratio of the nonconcurring railroad's new rates over its competitive route.

In our case, our western connections all serve the Chicago Gateway on traffic to the East, and we serve the Kewaunee, Wisconsin, Gateway to and from the East. Kewaunee Gateway is an alternative to a more crowed Chicago Gateway and with a fair application to rates, offers a shipper a choice. We connect at the East with C&O[1] which itself services a portion of the eastern territory as well as interchanging with other carriers at such points as Toledo, Ohio. Until recently, Ann Arbor Railroad also connected with GB&W at Kewaunee, and served Toledo where interchanges where made with six other eastern carriers. Four of these eastern connections also serve the Chicago Gateway direct.

The new procedures for establishment of joint rates require concurrence from each participant in a particular route rather than the former method of using the rate bureau procedure. The cumbersome nature of this procedure and the time and effort involved limits the number of rates and routes in which we seek to participate.

When such an approach is made to seek concurrence of each joint rate participant on traffic moving via Kewaunee, both eastern and western carriers, in a majority of the cases, will not grant it. We have been told repeatedly, especially by the eastern railroad, that concurrence will be granted, if at all, only via a route which accords that carrier a Chicago Gateway haul. In a good number of these cases, the revenue to variable cost ratio is equal to, and sometimes better via the Toledo Gateway, but total revenue is greater via Chicago for that individual carrier.

As an example, Conrail serves South Brunswick, N.J., exclusively, and synthetic plastic moves from that origin to Green Bay, Wisconsin, which is served by three carriers including the Green Bay and Western. About a year ago when we reviewed this matter, Conrail would earn $2,135 or a revenue to variable cost ratio of 1.67 via Toledo as opposed to $2,836 or a revenue to variable cost ratio of 1.63 via Chicago. Conrail's Mr. D. L. Bodnar advised us on March 1, 1982, that "Our [Conrail's] earnings will not support a rate of 246¢ (rate at current level) per cwt., minimum weight 170,000 lbs. via Toledo, Ohio, interchange. The only route which will support this rate is via our Chicago, Illinois, interchange." This action effectively shuts out competition via any gateway other than that which produces the largest dollar value of Conrail even though its revenue to variable cost ratio was better via Toledo.

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[1] Via car ferry service formerly provided by C&O—now provided by Michigan-Wisconsin Transportation Co.

In another example of such action, GB&W serves a large producer of canned goods at Plover, Wisconsin. This shipper had requested 120,000 lb. minimum canned goods rates to Salem and Woodstown, N.J., the same as then published via Kewaunee, Wisconsin, to Swedesboro, N.J., which applied via Kewaunee Gateway as well as via the Chicago Gateway in Item 1560-series, WTL 3329–Q.

According to our figures, Conrail would earn $1,924 at a revenue to variable cost ratio of 1.99 via Toledo, yet rates via this Kewaunee-Toledo Gateway were refused and concurrence given only via Chicago where Conrail's revenue was $2,145 but revenue to variable cost ratio was only 1.70.

These are not isolated instances. In many cases, the Eastern Lines revenue to variable cost ratio via Kenwaunee, Wisconsin, is within a few percentage points of the ratio available via the Chicago Gateway. The major diference is that most major eastern line carriers serve Chicago direct, and retain the entire division portion east as opposed to dividing that revenue between two carriers via the Kewaunee, Wisconsin, Gateway. Thus apparently for cash flow reasons, revenue to variable cost relationships carry very little weight and GB&W competitive routes are being declined on many such requests on a daily basis.

Attached as an example are copies of several letters from certain railroads to GB&W declining to participate via the Kewaunee Gateway. This action, if continued without restraint, can only lead to the economic closing of the Kewaunee Gateway which is the GB&W's only directly served gateway to the East.

In addition to the ongoing disability of the Green Bay and Western in obtaining concurrences on new joint rates, we are faced with action taken to reduce our opportunity to participate in existing joint rates. A prime example is Conrail routing changes covered by ICC Docket No. 38676 on which suspension was not granted. Prior to the cancellation by Conrail of our joint rates with it when the C&O is the intermediate carrier, GB&W had access to both AA and C&O to get to Conrail destination points via the Kewaunee Gateway. In the seven months prior to Conrail's action, we averaged 1,279 cars via the AA to the East and during the seven months immediately following Conrail's action, we averaged 1,255 carloads per month for only a slight decline of 1.8 percent. On the other hand, via the C&O, which route to Conrail was cancelled during the course of the proceedings, our average dropped from 582 cars a month for the same prior period to 456 after, a decline of 21.6 percent. We know that all these carloads were not destined to Conrail in either case (breakdown is not available to us), but due to the predominant number of destinations served by Conrail in this territory, we are satisfied that it does illustrate the effects of this route closing on our small railroad.

After consideration of the record in the proceeding (Docket No. 38676), the Commission held that it was not in the public interest for the Kewaunee Gateway via the C&O to be closed to the Green Bay and Western, recognizing that GB&W's access to the East via Kenwaunee over the lines of the Ann Arbor was in jeopardy. Unfortunately, in ordering the reinstatement of the GB&W's joint rates through Kewaunee via C&O, the Commission made the restablishment of such joint rates contingent upon obtaining concurrences from all of the individual railroads which had previously participated in such joint rates.

As well might be expected, some of these former participants refused to concur in the reestablishment of such joint rates and certain rates remain cancelled even though the Commission had ruled that it is not in the public interest for Conrail to be allowed to close GB&W's Kewaunee Gateway via C&O. The effect is that it is apparently in the public interest to allow participating railroads other than Conrail to cancel such joint rates by refusing to concur in their reestablishment. Obviously, this irrational result does not serve the public interest. The solution should have been for the ICC to suspend proposed joint rate cancellations until after its investigation; or, at the very least, to order the concurrences automatically reestablished in the cancelled joint rates whose cancellation the Commission concluded was not in the public interest.

ICC Docket No. I & S 9256 covers the Union Pacific Railroad cancellation of joint rates via the Ann Arbor on soda ash. As GB&W is an intermediate carrier in such joint rates, this had the effect of having its joint rate cancelled too. Soda ash deposits are located on the lines of the Union Pacific only, and UP originates all of it from the Wyoming points of origin. The Green Bay and Western participated in soda ash movements as a major connection of the Ann Arbor, but when increased tonnage began to move over this route, we were met with the UP rate cancellation which was approved by the Commission. We do not believe it is in the public interest to permit a large railroad like UP which is a participant in all of these soda ash shipments as the sole originating carrier to dictate which other railroads may compete. Surely, UP's control of the origins guarantees its profits without it controlling which carriers may compete as intermediate carriers.

These cancellations were approved by the Commission under Section 10705(e) rather than 10705a primarily because the revenue/cost ratios were too high to qualify for the special remedy available under 10705a. The revenue to variable cost ratios over the line of movement on the UP via the GB&W routing were profitable to UP with a number of the cancelled rates providing them as high as 180 percent ratios. The real effect is anti-competitive in that a shipper no longer can use the alternative competitive route and the small railroad has been deprived of its right to compete.

Another fairly recent example of a very harmful joint rate cancellation resulting in serious traffic losses to the GB&W was instituted by our largest and most important western connection, the Burlington Northern. The action of BN was to file tariff amendments providing that any lumber shipments originating on the BN for destinations beyond Chicago, Illinois, would be restricted to delivery to BN connections at Chicago. GB&W has long provided competitive service to eastern destinations by joint rates with BN which were summarily cancelled by this action. By the time GB&W learned of this action, the time within which to protest had almost expired, and our opportunity to register an effective protest was virtually nil. One of the problems for small railroads is that they do not have enough staff nor enough resources to employ enough staff to keep currently advised of such actions.

This kind of action by large carriers is anticompetitive. Its justification is to provide the large origin carrier with control of origin traffic for its longest haul regardless of available competitive routes and regardless of how efficient such competitive routes may be. The result is elimination of a shipper's option to select a competitive route and elimination of the small railroad's right to compete.

Another similar blanket cancellation of our joint rates was recently effected by the newly merged Norfolk Southern System when they cancelled joint rates in which we participated via the C&O Toledo Gateway. This action went into effect before our marketing department was aware of it, so we had no real opportunity to seek ICC protection. This, however, probably saved us the trouble of protesting unnecessarily, because the Commission has made it very clear that it is not concerned about maintenance of competitive joint rates via small railroad alternatives.

The Congress should look with concern on these kinds of anti-competitive actions and take action to ensure that its dedication to competition expressed in the Staggers Rail Act does not become completely disregarded. Small railroads cannot compete and possibly cannot exist if their joint rates are all cancelled—and the goal of those cancellations to assure the longest possible haul to the large carrier is not a worthwhile public goal.

I appeared before this Subcommittee at Oversight Hearings about one year ago and expressed alarm at the way the Commission is implementing the Staggers Rail Act's joint rate provisions. Since that time, matters have worsened—not improved. I urge this Subcommittee to get involved and take action to ensure that small railroads are not driven to the wall by continued cancellations of their joint rates.

STATEMENT OF GORDON E. NEUENSCHWANDER, EXECUTIVE VICE PRESIDENT, PITTSBURGH & LAKE ERIE RAILROAD CO.

Mr. Chairman and Members of the Subcommittee: Thank you for the opportunity to appear before you today to share with you some views held by The Pittsburgh and Lake Erie Railroad Company (P&LE) regarding the serious deterioration of competitive joint routes and rates which the ICC has permitted to occur in the name of deregulation. P&LE concurs in and shares the views of other members of this panel, representing regional Class I, Class II and Class III railroads, and which have been forcefully stated in Mr. Burdakin's testimony to this Subcommittee. Before detailing the serious financial and anticompetitive impact which Conrail joint route and rate cancellations have had on the P&LE, let me first give you a few brief facts concerning the P&LE.

P&LE is a small, regional Class I railroad, principally engaged in providing freight service over 245 miles of main line track, serving southwestern Pennsylvania and northeastern Ohio. Our main lines extend north from junctions at Connellsville, Pennsylvania, with the Chessie System, and at Brownsville, Pennsylvania, with the Monongahela Railroad. These lines join at McKeesport and extend north through Pittsburgh, Aliquippa, and Beaver Falls to Youngstown, Ohio. From there, P&LE provides freight service north via trackage rights over Conrail to iron ore and coal docks at Ashtabula, Ohio and northeast from Youngstown via trackage rights over Conrail through Sharon, Pennsylvania, to a connection with the Bessemer and Lake Erie Railroad at Shenango, Pennsylvania. A map of the P&LE system is attached for your reference. (Exhibit A).

P&LE has had a corporate existence and has been profitably operated for over 100 years, until 1982. For many years, it was a subsidiary of The New York Central System and later the Penn Central Transportation Company. As a result of congressional action, P&LE was excluded from the rail properties which Penn Central conveyed to Conrail in 1976. In 1979, Penn Central sold the railroad to a privately owned holding company now known as Pleco, Inc. Its headquarters remain in Pittsburgh and until 18 months ago, we employed as many as 2,300 people.

For many years, a distinguishing feature of P&LE has been its relatively large fleet of freight cars. Of all the railroads operating in the northeast, the size of P&LE's car fleet ranks fourth behind Chessie, Conrail and N&W. On June 1, 1983, the P&LE owned, leased and operated approximately 17,000 freight cars of various types. P&LE's commitment to its shippers and to its large car fleet was reinforced in 1979 and 1980 when it acquired 2,750 gondola and hopper cars, having a total value of over $100 million. In 1982, P&LE acquired an additional 400 specialized gondolas with a value of $17 million dollars, to be used by our primary steel producing customers for shipments of oil field drilling pipe.

P&LE traffic consists primarily of bulk volumes of coal, coke, iron ore and semi-finished iron and steel products. A small proportion (perhaps 25 percent) of our business involves a wide variety of industrial products for shippers large and small. Such traffic is nevertheless important to the P&LE in terms of the revenue it provides. However, from 1980 to present, P&LE has seen a precipitous decline in its carloadings and total revenues. The following figures are illustrative of this problem.

[Dollars in millions]

	Car loadings	Gross revenue
Year:		
1980	270,543	$83.5
1981	238,958	82.6
1982	146,673	47.2
1983 (first half)	61,750	20.0

Approximately 30 percent of P&LE traffic is local business which originates and terminates on P&LE lines; and 70 percent involves interline business with other railroads, mainly Conrail, N&W and the Chessie System. Accordingly, over two-thirds of our traffic involves handling with other carriers.

The volume of traffic interchanged with Conrail is especially valuable to the P&LE. The large extent to which P&LE interchanges traffic with Conrail reflects not only the historical fact that P&LE has been affiliated for many years with Conrail's predecessors, the New York Central and late Penn Central, but also that Conrail, an amalgamation of six northeast railroads, was granted an extensive rail network that serves most of the shipping points within the northeast which are important to P&LE customers. In 1979, the last full year before the onset of the current recession, the number of cars interchanged between the P&LE and Conrail at Youngstown ranked seventh in the entire nation. That same year, P&LE and Conrail interchanged an additional 21,000 carloads of freight at other junctions. An indication of the importance of Conrail to P&LE is demonstrated by the following interchange statistics for the years 1979 through June of 1983. The figures listed below indicate the carloads and revenue received by P&LE for shipments which it originated or terminated jointly with Conrail in 1979 through 1982.

[Dollars in millions]

	Car loadings	Gross revenue	Percent
Year:			
1979	103,000	$23.4	46
1980	72,000	18.0	38
1981	49,000	14.8	30
1982	20,000	6.0	17
1983 (first half)	7,000	2.9	15

These carload and revenue statistics indicate the magnitude of the market for joint line rail traffic between P&LE and Conrail.

P&LE's share of much of this essential market was effectively destroyed by Conrail in 1982, when it published Item 815 in Supplement 11 to Master Tariff RRRA 6000-G, Changes in Lists of Participating Carriers and Routing Instructions to Reflect Restructuring of the Northeast and Midwest Railroads Pursuant to the Regional Rail Reorganization Act of 1973, *as amended*. (Exhibit B). This tariff contains routing instructions for carriers within Official Territory (i.e., Northeast United States). These routes were adopted by all railroads in the Northeast after the creation of Conrail in 1976 under the Final System Plan. In Item 815 Conrail has restricted routing on originating and terminating traffic at stations served by Conrail to apply only via "Conrail Direct". The effect of this restriction means that shippers may use only Conrail for shipments destined to or originating at Conrail stations. No other carrier can participate with Conrail on a joint basis to handle any of this traffic. Thus, shippers no longer have a choice between alternative competitive routes. Confirmation of this fact was provided to P&LE by Conrail's then Vice President of Marketing, Richard H. Steiner, who advised that Item 815 "is to restrict Conrail's participation to Conrail local service between industries reached by Conrail either directly or through reciprocal switching." (Exhibit C).

Conrail has, in effect, refused to participate with P&LE in joint rates and routes in the following representative situations:

(A) At Conrail station points which are also listed as stations for other carriers. Conrail intends to apply Item 815 so as to preclude a shipper at a multiple station point from using a route in conjunction with other originating carriers where the destination point is on Conrail or served by Conrail via reciprocal switching. For example, shipments of scrap from U.S. Metals Corp. at Sharon, Pennsylvania, to Latrobe Steel Company at Latrobe, Pennsylvania, which heretofore moved via a P&LE-Conrail route, will as a result of Item 815, move Conrail direct because both P&LE and Conrail serve Sharon, Pennsylvania, as a common origin point and not necessaarily for the reason that the Conrail rate is cheaper. Similarly, shipments of scrap from Babcock and Wilcox Tube Works at Koppel, Pennsylvania, to Quanex Corporation at Jackson, Michigan, which heretofore moved via a P&LE-Conrail route will, as a result of Item 815, move Conrail direct because Koppel, Pennsylvania, is served by both P&LE and Conrail.

(B) At stations not on Conrail but open to Conrail direct routing via reciprocal switching provided by another carrier. For example, at J&L Steel's southside plant, the Monongahela Connecting Railroad, an industrial switch line owned by J&L Steel Corporation, originates shipments of ammonium sulfate for movement to Agway Corporation destinations at Union City, Pennsylvania and Lyons, New York. These shipments which heretofore moved via a P&LE-Conrail route will, as a result of Item 815, move via a Conrail direct route because the Monongahela Connecting Railroad provides switching services to both P&LE and Conrail and is being Treated by Conrail as a common origin point for purposes of Item 815.

On December 9, 1982, P&LE intervened as a matter of right under 49 C.F.R. § 1112.4(c) in the Interstate Commerce Commission's Investigation and Suspension Docket No. 9258 to participate in the public interest determination which the ICC is required to make in route cancellation cases under 49 U.S.C. § 10705(e). However, on January 7, 1983, the ICC issued an order revoking its previous suspension order and terminating this investigation and suspension proceeding. As a result, the Item 815 cancellation became effective shortly thereafter. P&LE has 16 common competitive points with Conrail. Traffic volumes over these joint routes fluctuate from time to time, depending on rate levels, car supply, intermodal competition, plant production, and other market or transportation conditions. In 1981, P&LE moved more than 1,700 carloads of traffic to or from Conrail served points via P&LE-Conrail routes from which P&LE derived $650,000 in revenues. In 1980, more than 2,800 carloads of traffic moved to or from conrail served points via P&LE-Conrail routes from which P&LE derived more than $900,000 in revenues. In both years, Conrail also maintained its own single line routes from the same points. If Item 815 had been in effect, all of this traffic would have moved Conrail direct and P&LE would not have received a single dollar of freight revenues. P&LE has filed a formal complaint with the Interstate Commerce Commission challenging the legality of the Commission's decision and Conrail's route and rate cancellations. In the meantime, these joint routes and rates remain cancelled and the shippers which P&LE serves no longer have the option of including P&LE as a line haul carrier for shipments moving to local Conrail destinations.

Each carrier does maintain local tariff routes to and from points on its own line, and these local routes are not affected by Conrail's joint route cancellations. In the absence of joint routes, a shipper, such as U.S. Steel at Homestead, Pennylvania (served by the Union Railroad which connects with both Conrail and P&LE) would have to use a combination of local routes and rates to move a carload from Homestead to a local Conrail desination point at Chicago. The ICC and Conrail contends that the availability of a combination of local routes and rates represents a viable, competitive method for handling the joint movement of traffic. This contention has no basis in fact. Conrail has told the Commission that Item 815 merely cancels joint rates, which results in a price differential between the remaining Conrail single line rate and the combination of local rates that apply for the competing joint line move. This is a gross distortion of the commercial reality which flows from Item 815. In the absence of joint rates and routes, there is a price differential which greatly favors Conrail single line routes, but there is also much more. Local rates and routes are just that; they are local to one railroad. Without local participating joint rates and routes, each railraod would be required to prepare its own bill of lading for its local move and render a separate bill to the shipper or consignee for that local movement. A car would be consigned to the agent of the connecting carrier at the interchange point with instructions to contact the shipper or consignee for routing and billing instructions for the next segment of the movement under the connecting carriers local routes and rates. This is, in effect, a return to practices which were prevalent in the industry nearly 100 years ago. It is an inefficient, costly, time consuming process that results in duplicative paperwork and delay for both shippers and carriers. Even if for competitive reasons or through shipper pressure, Conrail were to agree to establish local combination rates that were competitive with its own single line rate, the administrative burden of rebilling local movements and dealing with each carrier in a multiple carrier move would make use of combinations of local rates unfeasible. The ICC has completely ignored these factors in reaching its decision that Item 815 is not a route closing.

Conrail does not need to tear up its track to close a route. It has accomplished the same result by forcing its connections and the shipping public to utilize commercially unworkable procedures for handling and billing joint movements of traffic. These non-tariff barriers, in my view, constitute a route closing as surely as if Conrail had ripped up its interchange tracks with the P&LE.

Where a carrier serving a destination cannot provide the origin shipper with the proper type of car, the shipper often originates the shipment using another carrier's equipment which also serves to origin point and can supply the proper cars. In recognition of the benefit conferred by supplying the proper equipment, a shipper often routes those movements so as to include the carrier which supplied the car.

P&LE has acquired a large, modern fleet of plain and specialized gondolas, flat cars, open and covered hopper cars, open and covered coil cars, and specialized boxcars with which its serves heavy industry. This car fleet totals 16,945 cars and, as mentioned above, it the fourth largest car fleet in the Northeast United States.

P&LE has utilized this large fleet of almost 17,000 cars to solicit and participate in freight revenues for jointly routed shipments originating at stations served by both P&LE and Conrail. P&LE also earns car hire revenue from its connecting carriers for the use of P&LE equipment while the equipment is off P&LE tracks. Item 815 inhibits the use of P&LE cars on shipments destined to or originating on Conrail stations, thereby limiting the competitive service options which are available to shippers, and greatly increasing the cost of P&LE's investment in rail cars. Conrail's cancellation of P&LE-Conrail joint routes and rates places in jeopardy millions of dollars of specialized freight equipment acquired by P&LE. Item 815 also prevents shippers served by P&LE and Conrail from using joint routes to obtain P&LE equipment and to short haul Conrail when Conrail's price or service is not satisfactory to the shipper. Without joint through routes with Conrail, there is no way P&LE can provide competitive transportation for shipments from the thousands of industries in the northeastern United States served only by Conrail. These through routes are unique and irreplaceable.

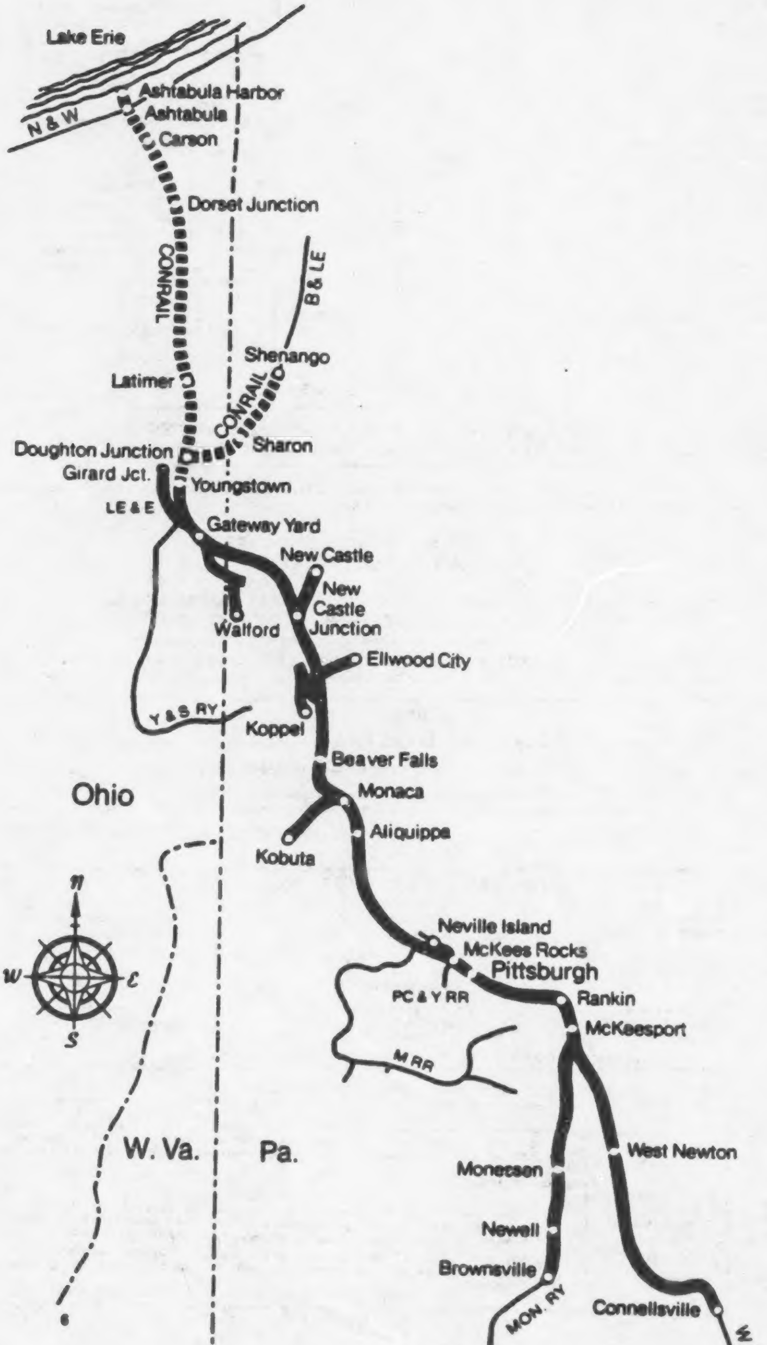
Finally, a large number of Pennsylvania and Ohio industries which relied on P&LE service to market their goods are now restricted solely to Conrail for rail services. There is no guarantee that Conrail's recently acquired reputation for good service and car supply pressure on its equipment supply. Shippers will be left without competitive alternatives for their rail traffic when business activity increases.

At the present time, P&LE faces serious financial problems. The widely heralded economic recovery has yet to reach the Youngstown-Pittsburgh steel industry. In 1982, for the first time in over 100 years, the P&LE lost money. The 1983 figures and projections indicate no improvement. P&LE has been required to go to its lenders and request assistance in restructuring its debt and other financial obligations.

In these circumstances, it is intolerable for Conrail to use its monopoly power to close P&LE out of competitive routes to Conrail local points. In 1980, Congress passed the Staggers Rail Act. It envisions that competition will act as the primary regulator of railroad rates and services. However, the Congress did not intend that large Class I railroads should have the right to cancel competitive route and rate relationships with smaller carriers which provide the bulk of intramodal rail competition in the industry today. The example set by Conrail has been followed by other large Class I rail carriers, and has resulted in increased concentrations of economic power in the hands of these large railroads. These actions are diametrically opposed to the pro-competitive policy which Congress sought to promote by passing the Staggers Act. The Interstate Commerce Commission has refused to take any effective action to insure the maintenance of competitive joint routes and rates. It would be the supreme irony if congressional action taken to insure the long-term vitality of the rail industry through promoting greater competition in fact results in the concentration of market power in the hands of a few giant railroads and sets the stage for subsequent re-regulation of the industry.

We join with Mr. Burdakin in urging serious consideration and prompt remedial action to restore intramodal competition to the railroad industry.

Exhibit A


Lake Erie
N & W
Ashtabula Harbor
Ashtabula
Carson
Dorset Junction
CONRAIL
B & LE
Shenango
Latimer
CONRAIL
Doughton Junction
Sharon
Girard Jct.
Youngstown
LE & E
Gateway Yard
New Castle
New Castle Junction
Walford
Ellwood City
Y & S RY
Koppel
Beaver Falls
Monaca
Ohio
Aliquippa
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Pittsburgh
PC & Y RR
Rankin
McKeesport
M RR
West Newton
Monessen
W. Va.
Pa.
Newell
Brownsville
MON. RY
Connellsville
W.M

Exhibit B
R36-

SUPPLEMENT 11
Supplements 3, 7, 10 and 11 contain all changes.

TO

ISSUING AGENTS	ICC NO.	CTC(F) NO.	STATE COMMISSION NOS.
E. F. Baughan	RRRA 6000–G	182	ILL CC 68, INRC RRRA 6000–G, MPSC RRRA 6000–G, MDPSC RRRA 6000–G, NY–DOT RRRA 6000–G, OH PUC RRRA 6000–G, PA PUC RRRA 6000–G, VA SCC RRRA 6000–G, WV PSC RRRA 6000–G.
P. J. Lavallee....................		2639	....
K. W. Juvonen....................		1080	....
Southern Freight Association		S–530	ILL CC S–231, IN RC RRRA 6000–G, OH PUC RRRA 6000–G, VA SCC RRRA 6000–G.
Southern Ports Foreign Freight Committee ...		154	....
Southwestern Freight Bureau		1114	IL CC 168.
Traffic Executive Association – Eastern Railroads....................		C–641	IL CC –196, IN RC RRRA 6000–G, MD PSC RRRA 6000–G, MA DPU RRRA 6000–G, MPSC RRRA 6000–G, NH PUC RRRA 6000–G, NJ–DOT RRRA 6000–G, NY–DOT RRRA 6000–G, OH PUC RRRA 6000–G, PA PUC RRRA 6000–G, RI PUA RRRA 6000–G, VT PSC RRRA 6000–G. VA SCC RRRA 6000–G, WV PSC RRRA 6000–G.
Trans–Continental Freight Bureau		1053	....
Western Trunk Line Committee..........		A–1578	IL CC 696, IN RC RRRA 6000–G. MPSC RRRA 6000–G.

MASTER TARIFF RRRA 6000–G

APPLYING FOR ACCOUNT OF ALL CARRIERS AS SHOWN IN TARIFFS AND SUPPLEMENTS SUBJECT HERETO

SPECIAL NOTICE: This Tariff is Applicable Only in Connection with Tariffs and Supplements made Subject to this Tariff and to the Extent Indicated in Tariffs and Supplements made Subject to this Tariff.

CHANGES IN LIST OF PARTICIPATING CARRIERS AND ROUTING INSTRUCTIONS
TO
REFLECT RESTRUCTURING OF NORTHEAST AND MIDWEST RAILROADS PURSUANT TO THE REGIONAL RAIL REORGANIZATION ACT OF 1973, AS AMENDED.

This form of publication authorized by ICC Permission No. 76–3000 of March 5, 1976, Canadian Transport Commission Special Permission No. 5327 of February 23, 1976 and Michigan Public Service Commission Special Permission No. 4095 of March 11, 1976

NOTICES

The provisions published herein will, if effective, not result in an effect on the quality of the human environment.

Expires with July 1, 1983, unless sooner cancelled, changed or extended.

This Tariff will be reissued effective not later than July 1, 1983.

ISSUED: OCTOBER 19, 1982 **EFFECTIVE: NOVEMBER 13, 1982**

TARIFF PUBLISHING OFFICERS OR AGENTS

E. F. BAUGHAN
2 North Charles Street
Baltimore, MD 21201

J. J. DOLAN
222 South Riverside Plaza
Chicago, IL 60606

W. J. HARDIN
300 West Adams Street
Chicago, IL 60606

C. M. HERZBERG
1015 Locust Street
St. Louis, MO. 63101

K. W. JUVONEN, Agent
1200- 215 Garry Street
Winnipeg, MB, R3C 3P3

J. L. TWIGGS
151 Ellis Street, N. E.
Atlanta, GA 30303

P. J. LAVALLEE, Agent
1162 St. Antoine Street
Montreal, PQ, H3C 1B

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SUPPLEMENT 11 TO MASTER TARIFF RRRA 6000-G

ITEM	SUBJECT	ROUTING INSTRUCTIONS
● 815 (New)	Routing between Stations on Consolidated Rail Corp.	Routing on traffic originating and terminating at stations served by Consolidated Rail Corporation will for the account of Conrail apply only via CR direct. See exceptions EXCEPTIONS 1. This item has no application when shipper or receiver or shipper and receiver are located on railroads (other than Conrail) on sidings closed to reciprocal switching prior to November 13, 1982. 2. The provisions of this item will not apply on dimensional shipments which, because of size or weight, require special route for Clearance purposes. (CR 3195)

● - Increase.

BEST COPY AVAILABLE

EXHIBIT C

CONRAIL,
October 29, 1982.

Mr. R. H. GEORGE,
Vice President, Marketing & Sales, The Pittsburgh & Lake Erie Railroad Co., Pittsburgh, Pa.

DEAR DICK: This will respond to your letters of October 27, 1982, seeking tariff interpretations involving routing provisions in Item 815 of ICC RRRA 6000-G and circle reference 302 of ICC TEA 5560-C.

With respect to the former, the effect of Item 815 is to restrict Conrail's participation to Conrail local service between industries reached by Conrail, either directly or through reciprocal switching. Otherwise, the exception for industries not open to switching would be meaningless. In the case of your Bessemer example, any industry reached by switch absorption by Conrail at Bessemer which ships tonnage via Conrail to any industry reached by Conrail (either directly or by switch) will employ Conrail as the only line-haul railroad.

With respect to circle reference 302 in ICC TEA 5560-C, the situation is different. There we have provided two separate paragraphs, each equally applicable. Paragraph A provides that if Conrail originates the traffic it must move via Conrail direct to the gateway. Paragraph B provides that if a carrier other than Conrail originates the traffic, the route to the gateway must include only one direct connection of Conrail's. There is no distinction in Paragraph B between local stations on the carrier other than Conrail versus stations on that carrier which are common points with Conrail. All stations, local or common, are eligible for joint routing via Conrail to the gateway, provided that not more than one direct connection of Conrail's is included in the route.

I hope this will clarify the tariff material for you. If you have a situation involving special equipment which is impacted by our recent amendment in ICC RRRA 6000-G, I would appreciate your consideration in calling it to the attention of our Business Group people involved. We have made some exceptions to the general effect of our publication under similar circumstances and are willing to consider others on a case-by-case basis.

Yours truly,

DICK.

Senator **DANFORTH**. Thank you, sir.

Mr. Gensburg.

Mr. **GENSBURG**. Good morning, Mr. Chairman. My name is Robert Gensburg and I am president of the Lamoille Valley Railroad Co. We operate a 98-mile-long short line railroad serving 31 shippers in 12 small communities in the northern part of the State of Vermont.

As a member of the Short Line Legislative Coalition, I also speak today for four other short line railroads located in Illinois, New York, Pennsylvania, and Ohio. These five railroads have pooled resources to try to affect legislation that affects us. In a very real sense, however, our problems are similar to many of the more than 350 short line railroads in the United States.

Short lines are small businesses which provide, in many instances, the only access their customers have to their markets. According to Small Railroads, an AAR publication, 352 short line railroads averaged $540,000 in gross revenues in 1980, on which they earned an average of $82,000 in net income.

The aggregate gross revenues of all of these small railroads was less than that of one of the Lamoille Valley's connections, the Guilford Railroad System, and the Guilford System is a small railroad compared to other class I carriers. Like other small businesses, we tend to be aggressive competitors and deregulation has tended to help us in this regard.

For example, the Lamoille Valley Railroad was the first railroad in New England to enter into contract rates. In fact, our first contract was for boxcar storage and transit, an innovative marketing device that has now been successfully copied by other carriers, both large and small.

Mr. Chairman, in my summary of my written statement, which has been submitted for the record, I will focus first on the effect of closings on small railroads, and, second, on the effects of the boxcar deregulation decision on small railroads, which you have asked me to talk about.

These issues are related because both have to do with the relative market power of short line railroads and class I carriers. We are small businesses which physically must rely on our giant neighbors in order to remain in existence. We cannot pick up our assets and move to another market.

During the first 90 years of its existence, the Interstate Commerce Commission served as the umpire when disputes arose between carriers, including short lines and their trunk line connections. That is not the case today. Short lines continue to need a check against abusive power by the large connections because of the differences in bargaining power.

The antitrust laws do not provide an adequate remedy to short lines because of the expense and risk involved in trying such a law suit. Moreover, we do not want to be litigating against carriers with whom we must simultaneously cooperate in handling our joint traffic.

With respect to route closings, I think a simple and typical example from my railroad will demonstrate the impact of route closings on small railroads and, more important, their shippers. Traffic originating from Gilman, Vt., on the Maine Central and terminating in Iowa was routed under a joint rate over three different routes involving various other carriers.

One of those routes included the Lamoille Valley and we handled approximately one of every four cars originating there. Early this year, the Maine Central established a new lower rate over only one of those routes, which did not include the Lamoille Valley. The new rate also did not include the Canadian Pacific. The CP, with its market power, recently managed to get its route included in the new lower rate.

Despite repeated attempts and the concurrence of every other carrier in our route, we have not been able to obtain inclusion in that rate, notwithstanding the fact that there are fewer interchanges over our route, lower transit time our way, and that the Maine Central would receive not a dime less in revenue and would not incur 1 dime more in cost for handling the traffic with us. As a result, we lose about 100 cars a year and 4 percent of our gross revenues.

This type of action clearly affects our ability to survive and it also obviously affects the ability of the shipper to obtain the most efficient routing.

Equally troubling is the Commission's boxcar deregulation decision. For one example, a recent seminar I attended. A speaker from a large western railroad said 10 times, if he said it once, that his railroad was 3,039 miles long and that an empty boxcar return at 35 cents a mile would cost the car owner over $1,000.

The Lamoille Valley ships talc in boxcars almost to the far end of that railroad. Our gross revenue, including car hire, from that traffic is substantially less than the potential empty return charge. Now just how bilateral do you suppose our rate and car hire negotiations will be with this railroad? This is not competition in the marketplace; it is blackmail.

We wanted to say that we are pleased that the DOT has recognized the problem that boxcar deregulation will cause the class III railroads, and I understand that they spoke to this committee yesterday on that point.

Mr. Chairman, in summary, the Short Line Legislative Coalition supports strongly the goal of a competitive, efficient rail system that relies primarily on market mechanisms. It is clear, however, that the unfettered market power of large carriers is inconsistent with this goal, particularly when such carriers act to inhibit the access of short lines to the national rail system, whether through the expedient of route closing, anticompetitive equipment, or rate practices under boxcar deregulation.

If the short lines are afforded a fair opportunity to compete, we will do so vigorously. If you have any questions, obviously I would be happy to answer.

[The statement follows:]

Statement of Robert L. Gensburg, President, Lamoille Valley Railroad Co., on Behalf of the Short Line Legislative Coalition

Mr. Chairman, my name is Robert L. Gensburg. I am President of the Lamoille Valley Railroad Company, a 98-mile short line railroad located in the State of Vermont. I am appearing before you today on behalf of my railroad and four other short line railroads: the Cairo Terminal Railroad Company (CTML) located in the State of Illinois, the New York & Lake Erie Railroad Company (NY&LE) located in the State of New York, Pocono Northeast Railway, Inc. (PNER) located in the Commonwealth of Pennsylvania, and the Spencerville and Elgin Railroad Company (SPEG) located in the State of Ohio. Knowing the importance of acronyms to identify collective interests, we have designated our informal group as the Short Line Legislative Coalition or SLIC. The common denominator of our group is simply that we are Class III railroads (i.e., railroads having less than $10 million in annual gross revenues and switching and terminal railroads—known colloquially as "short lines") concerned about the impact upon Class III railroads of certain developments under recent legislation, particularly the Staggers Rail Act of 1980. The purpose of my appearance before you today is to discuss two such actions: (i) the spate of route closings permitted by Staggers Act reforms and related rate and access issues; and (ii) the so-called boxcar deregulation decision of the Interstate Commerce Commission.

As background to the discussion of these topics, I would like first, for the record, to touch on the increasing significance of short line railroads, particularly in a deregulated transportation system. Then I will describe the specific concerns and problems of our group with respect to route closings and boxcar deregulation, using examples drawn from the railroads participating in this group. I will conclude by setting out some principles we believe should guide formation of solutions to these concerns and problems.

I. SHORT LINES PROVIDE COMPETITIVE FREIGHT TRANSPORTATION IN A DEREGULATED ENVIRONMENT

Short lines are efficient small businesses that are aggressive competitors in the post-deregulation transportation system. Because the role of short line railroads is often misunderstood, however, some of the important characteristics of short lines should be highlighted briefly:

Service to shippers

Short line railroads provide the only access to the national rail system for many large and small shippers. In many cases, this rail service is absolutely necessary to the continued survival and growth of these firms. A local government study of the Spencerville and Elgin Railroad, for example, found that its rail service was of fundamental competitive importance to most on-line shippers and that without such service many shippers would close or cut back production because of increased transportation costs. In other cases, short line rail service provides an important constraint on rates for shippers that use several transport modes. In cases where short lines connect with more than one rail carrier, shippers are afforded neutral access to each line haul carrier. Such access can provide shippers with significant rate and service competition. Finally, shippers usually find that short lines provide a level of personalized, responsive service that meets and often exceeds that provided by larger carriers, particularly in low volume markets.

Economic efficiency

Because they are closer to the customers and are able to deploy their assets and work force with more flexibility, short line railroads often can operate light density rail lines more efficiently than larger carriers. This economic efficiency is well illustrated by the actual experience of SLLC members. For example, the three owner-employees of the Cairo Terminal Railroad are now providing more service at less cost on approximately 30 miles of lines than was formerly provided by two Class I carriers on the same lines. Such efficiency is not necessarily the result of a non-union vs. union work force. My railroad, for example, operates with a fully unionized work force that is extemely cost-effective.

Traffic retention for larger railroads

Short lines preserve and enhance traffic for their Class I connections. Consistent with the "feeder line" concept developed by Congress in the Staggers Act, short lines feed to larger carriers traffic that, but for the existence of short lines, probably would be lost to the national rail system. Beyond merely preserving existing traffic, many short lines have been able to increase traffic by combining innovative rate and service packages with aggressive, retail-oriented marketing.

Industrial development and community benefits

Short lines are often critical to the maintenance and expansion of the industrial base of the communities they serve. By preserving service on light density rail lines, short lines anchor existing firms with obvious secondary benefits to local income and employment. With improved service and competitive access to the national rail system, short lines can regenerate industrial development and promote employment. These impacts are not abstract or insignificant. For example, the Pennsylvania Department of Transportation estimated that abandonment by Conrail of the 42 miles of lines purchased and operated by Pocono Northeast Railway, Inc. would result in the loss of more than 1,000 primary and secondary jobs and the imposition of private and public costs of more than $8 million. Instead, PNER has employed 12 people to serve more than 50 shippers and is expected to provide more than 2,000 carloads to Conrail this year, most of which would otherwise have been lost to truck.

In some ways, short line railroads have benefited from and contributed to the deregulated environment that has developed in the wake of the Staggers Rail Act. As small businesses, short lines may have the most to gain from measures that increase flexibility and tend to reduce red tape, transaction costs and reporting requirements. Similarly, short lines generally have taken aggressive advantage of competitive initiatives, such as contract rates, permitted by the Staggers Act. As Class I carriers have moved to abandon more and more lines they cannot operate efficiently, short lines are often the only realistic hope for preserving service to rail-dependent shippers and communities. Similarly, as noted above, many Class I railroads have, by working with short lines, often retained line haul traffic while redeploying their assets for what are, to them, more productive uses. Because of the basic economic efficiency of short line carriers and the pro-competitive, economic benefits short lines can afford to shippers, other carriers and the public, short lines can and should continue to play an important role in the post-Staggers environment. As such, SLLC and most short lines remain supportive of the general goals of the Staggers Act.

Despite these salutory aspects of deregulation, however, the extreme concentrations of market power now taking place within the industry and the essentially unrestricted flexibility afforded large railroads have increased the already critical dependence of short lines upon their Class I connections. The essential point of this testimony is that this interdependence and the differential in market power between short lines and their connections mandate certain basic rights of access and safeguards against anticompetitive behavior if the national freight system and shippers are to obtain the economic and competitive benefits short lines offer.

The following material addresses the issues of short line access and market power in the context of route closings and boxcar deregulation.

II. ROUTE CLOSINGS AND RELATED ISSUES

A. Market access is critical to short line carriers

Because the routes of each carrier are geographically fixed, the rail industry is highly interdependent, with the majority of all rail traffic moving between two or more carriers. Short lines are even more dependent upon connections, with more than 80 percent of all traffic originating or terminating upon the short line being interchanged with another carrier—almost always a Class I carrier. In this context, competitive access to the national rail system is the difference between life and death for short lines and their customers. Unlike a small trucking company or airline, a short line cannot move to another market if it finds access to existing markets blocked by a large competitor. Unlike a larger railroad, a short line usually cannot choose among connections or close certain gateways in favor of others. In short, the short line must work through its connections if it is to provide any transportation service.

B. Large carriers have the market power to effect route closings unilaterally

Large carriers have virtually unlimited power to inhibit the competitive access of short lines, particularly as the Commission has interpreted the rights of such large carriers under the Staggers Act. Access in this context obviously is not merely a physical connection with another carrier but a commercial concept that embraces rates, routes and service. Route closings (i.e., reduction in access) can be affected by a variety of means: existing joint rates may be canceled or surcharged, single line rates may be reduced and coupled with a refusal to concur in a competitive joint line routing, switching rates may be increased to prohibitive levels, reciprocal switching agreements may be canceled, gateways may be closed or a carrier may flatly refuse to quote reasonable rates or enter into a contract rate for new tarffic.

Some of these practices were permitted prior to the Staggers Act, while other practices were permitted for the first time or liberalized under the Act. Each of the foregoing practices, however, can be used in an anticompetitive fashion, particularly where a carrier has considerably greater market power than its connection. Several examples should illustrate the range of this problem in the short line context.

My railroad, LVRC, has long participated in joint rates for tarffic originating on Maine Central and terminating west of Chicago. Maine Central recently lowered its rate on a route that does not include LVRC. The new route reduces the Maine Central division and the Maine Central line haul from 23 to 7 miles. The old joint rate remained unaffected. LVRC responded by attempting to contruct a lower joint rate that would permit it to compete with the new Maine Central route. The LVRC proposal offered Maine Central a division higher than Maine Central's new route. The LVRC proposal was concurred in by each carrier that would be a party to the new route: Central Vermont, Canadian National, Grant Trunk Western and Burlington Northern—each carrier except Maine Central, which unilaterally refused to concur in the competitive route or even respond to LVRC's inquiry. Maine Central refused to permit LVRC to participate in this traffic even though the yield to Maine Central was actually higher under the LVRC routing.

If the Maine Central route were more competitive than the LVRC routing in terms of cost or service, we would have no basis for complaint. The LVRC route, however, is a least as competitive as the other route. Thus, a competitive route was thwarted by the actions of a carrier with less than 10 percent of the total haul. The ultimate lose is of course, the shipper, who is deprived arbitrarily of a competitive route and rate by the unilateral action of one carrier.

Competitive access can be inhibited in other ways. The New York & Lake Erie Railroad owns and operates a former Conrail branch. Its sole connection is with Conrail at Salamanca, New York. The Chessie System (Baltimore & Ohio) also serves Salamanca, New York. The Chessie line connects physically with the same Conrail yard in Salmanaca that is used by NY&LE. In fact, the NY&LE and Chessie use adjacent tracks in Conrail yard. However, Conrail has refused to respond to NY&LE's request to effect a direct interchange with Chessie at Salamanca despite the fact that such a direct routing often would be considerably more efficient in terms of mileage, cost, energy consumption and transit time.

For example, if direct interchange were permitted, a boxcar originating on Chessie at Deshler, Ohio, and terminating on NY&LE at Cattaraugus, New York, would be interchanged once, at Salamanca. Under the current arrangement, the car would have to be interchanged twice, once from Chessie to Conrail at a Conrail gateway and another time from Conrail to NY&LE at Salamanca. The latter arrangement is less efficient and more expensive, more circuitous and more time-consuming. The result is that such traffic does not move by rail.

The foregoing examples are not intended to illustrate that large carriers are engaging uniformally in anticompetitive behavior against small carriers. However, these are not merely isolated instances but practices that are occuring with increasing regularity. The examples should illustrate the many ways in which large carriers with market power can and are inhibiting the competitive access of small carriers. As discussed below, for all practical purposes no constraints exist on this market power.

C. Staggers Act provisions regarding class III carriers have not been enforced by the Commission and are otherwise inadequate

Because Congress recognized that the extreme market power of large carriers under deregulation could reduce significantly the ability of small railroads to compete, certain rate protections for Class III carriers were included in Section 217 of the Staggers Act (sometimes known as the "Lee Amendment"). These relatively complex provisions were intended to permit Class III carriers to protest joint rate surcharges or cancellations that have an adverse effect on competition, affect the sole remaining route available to the carrier for the traffic involved (if the shipper will suffer market loss) or unduly infringe upon the short lines' aiblity to earn an adequate raste of return. A provisions intended to permit short lines to compete for certain off-line traffic within 75 miles of short line points also was included. These mechanisms were intended to permit rescission of proposed cancellations or surcharges, at least to the extent the proposed surcharges or cancellations result in rates exceeding certain revenue-to-variable cost levels.

Commission implementation of the Class III provisions, however, has rendered these provisions almost completely useless. In several cases, the Commission held that general allegations of violations of these protections would not result in automatic rescission of proposed surcharges or cancellations. Further, in a major case that presented squarely the issue of Class III protections, the Commission failed to reach a majority decision with the result that no relief was afforded the Class III carrier.[1] As predicted, that short line carrier ultimately went bankrupt and liquidated. In fact, SLLC is unaware of any case in which the Class III provisions of the Staggers Act have been invoked by the Commission to deny a surcharge or joint rate cancellation.

Even if the Class III provisions of the Staggers Act were enforced, however, they would not reach many types of anticompetitive behavior that currently exist. The Staggers Act provisions are premised on the existence of joint rates. Because of widespread commodity and car-type exemptions and contract rates, and because many larger carrier now are refusing to negotiate joint rates of any kind with short lines, statutory provisions tied to joint rates are of declining significance. Further, as the foregoing illustrations indicate, large railroads can reduce rail competition through rate actions without affecting existing joint rates in any way. This environment is one that is often hostile to short line railroads and the competitive benefits they can provide.

III. BOXCAR DEREGULATION

Both the rate and car hire aspects of the Commission's decision regarding boxcar "deregulation" will have major adverse impacts upon short line carriers. As above, the reasons for such impacts are related to the interdependence of the rail industry and differential in market power between short lines and larger carriers. As a result, service to shippers will be impaired and non-productive transaction costs will be increased, all without compensating benefits to the national rail system.

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[1] *Restructured Rates on Grain and Grain Products, Conrail,* 365 I.C.C. 635 (1982). It should be emphasized that the ICC has requested expressly the guidance of Congress in regard to the Class III provisions of the Staggers Rail Act. See Ex Parte No. 427, "Joint Rates Study—Report to Congress," (1982) (at p. iii).

A. Short lines' use of boxcars to meet the needs of their customers

The Commission acknowledges that its decision will have a serious impact upon short line railroads. Yet, while noting that short line carriers "may have good cause to be concerned," the Commission dismisses such concerns on the ground that small carrier interests must be sacrificed for the good of the "national rail system as a whole." [2] This, the Commission implies, is a small price to pay since short lines are really only alter egos for "individuals who invest in boxcars as tax shelters." [3]

The Commission's entire discussion of the impact of the decision upon Class III carriers betrays a certain economic naivete as well as a fundamental lack of understanding of the critical transportation function of such carriers.

A significant percentage of total short line traffic is originating—that is, it is shipped by a customer from a point on the short line to an off-line point. The originating carrier has the obligation to provide a car for his customer. Because carriers connecting with short line have been unable to provide acceptable equipment in a timely manner or because certain segments of this originating traffic require specialized equipment not available from a connecting carrier, many short lines have been obliged to obtain freight cars by lease or purchase simply to serve their own traffic. The timely provision of clean, high-quality equipment tailored to customer needs is not a tax shelter gimmick but one of the essential elements of the effort to provide competitive freight service. The benefits to customers and the national freight system are obvious.

B. Boxcar rate deregulation may have anticompetitive impacts upon short lines

The decision to eliminate regulation of all rates for commodities in boxcars will facilitate the further exercise of market power by large railroads. Again, the net effect may be to deny short lines and customers access to the national rail transportation system and to deny the rail system the competitive efficiency of small railroads.

An example illustrates the nature of the dilemma for small carriers. In 1982, my railroad was informed that a large connecting carrier intended to surcharge joint rates for certain boxcar traffic originating on LVRC. LVRC exercised its rights under the Staggers Act by requesting the ICC to determine the revenue-to-variable cost (R/VC) ratio of this traffic for the large carrier. The Commission stated that the large carrier's revenue-to-variable cost ratio was more than 200 percent for this traffic. As a result, the large carrier refrained from imposing its planned surcharge. This vignette illustrates that, at least in this case, the system worked.

It also demonstrates that the mere existence of certain basic safeguards often has a pro-competitive effect. Here, the parties reached a voluntary solution in a manner consistent with the goals of the Staggers Act.

Under boxcar deregulation the result would be quite different. The large carrier would be afforded the unilateral right to increase its rates without any constraints or even any disclosure regarding revenue-to-variable cost levels. If the large carrier's rate were increased to the level of surcharge as originally proposed, the customer probably would close its plant. Since this traffic is of far greater relative importance to LVRC than the large carrier, however, we would be obliged to attempt to make some response to the larger carrier's actions. In order for the traffic to continue to move, LVRC, which already moves this traffic at a rate level with a R/VC level below that of the large carrier prior to the surcharge, would be forced to lower its rate to a level that would be only marginally compensatory. The result is clearly an income transfer form a small to large carrier as the result of the bald exercise of market power. Such a result may be rational for the large carrier but is such a result pro-competitive? Does such a result foster system efficiency? We think not.

c. Deregulation of car hire rules for boxcars will have significant adverse impacts upon short lines

The decision to "deregulate" car hire rules for baxcars may be even more disastrous for short lines. Instead of permitting the car owner to realize its costs of ownership, a result mandated by law [4] and simple logic, the Commission's order would permit the car user to determine, through the empty mileage charge and per diem reclaim, the net return to the owner of the car. After boxcar deregulation, net boxcar compensation levels of Class I railroads would be determined by length of haul and whether the carrier is a net originator or net terminator of boxcars. Short lines, however, would be uniformly lacking in the market power necessary to negotiate a compensatory agreement.

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[2] Ex Parte No. 346 (Sub-No. 8), "Exemption from Regulation-Boxcar Traffic," (1983) (Slip Op. at 26).

[3] Id.

[4] Subsection 11122(b) of title 49 of the United State Code enacted in 1976 states that "The rate of compensation to be paid for each type of freight car shall be determined by the expense of owning and maintaining that type of freight car, including a fair return on its cost giving consideration to current costs of capital, repairs, materials, parts, and labor."

An example regarding imposition of the empty return charge indicates clearly the magnitude of the problem. PNER was created in 1981, years after the ICC's experiment with Incentive Per Diem, the regulatory scheme that was intended to encourage acquisition of boxcars by short line. In 1982 at the outset of its operations, PNER purchased several specialized boxcars from Conrail to meet the specific needs of its shippers,[5] financing the cars with secured borrowing. Car hire revenues received by PNER are used to help meet the financing obligations for these cars. PNER has decidedly not "come to depend upon car hire as [its] main source of income" as the Commission alleges short lines do.[6] Indeed, we are aware of very few such railroads.

Many of the customers using PNER cars ship their goods as far as California. PNER's gross freight revenues from such shipments are, in certain cases, as low as $185 per car. If PNER is faced with an empty return charge of 35 cents per mile, PNER stands to lose approximately $800 per car, before any allocation of operating expenses. Obviously, no business could continue to operate under such conditions.

D. Market mechanisms alone will not provide effective protection for short lines

The market mechanisms the Commission relies on to curb anticompetitive behavior will provide no protection to most Class III carriers. Again, PNER's case is illustrative. It owns 46 miles of track. This statistic alone should indicate that PNER has no reciprocal bargaining power with a Class I railroad to negotiate an empty return charge that will be less than the 35 cents per mile permitted by the Commission's decision. (The most PNER could charge an empty foreign car on its lines is $16.10) This hardly provides PNER the leverage necessary to bargain for a car hire rate that would balance empty return charges. Further, even if PNER were able to obtain a lower empty return charge, the transaction cost of negotiating a bilateral agreement with each carrier with which PNER participates in through routes would be prohibitive.

Under the ICC's order shourt lines would have the choice of increasing their rates to offset the empty return charge or storing their own cars and using cars of other carriers. Both responses are economically inefficient and commercially untenable.

Most short line shippers cannot withstand an increase in their rates of the magnitude required to offset these charges. In many cases, short lines will have to triple or quadruple rates merely to recoup empty return charges. The effect would be to force shippers to divert their traffic to other modes or, more perversely, to adjacent plants that may be fortuitously located on large railroads that happen to be net terminators of boxcars. Those shippers that cannot absorb higher shipping rates or shift production may be forced to close down. It is difficult to discern any benefits of efficiency from any of these outcomes.

By forcing shorty iines to "store" cars they have purchased or leased, the Commission's order would rob such small railroads of one of their most important competitive tools. Instead, short lines and their customers would be placed at the mercy of their connections to supply cars. Because of location and traffic flows, connecting carriers would often have to move their carrs empty to many short lines for loading. Beyond the obvious economic inefficiency of this result, there is no guarantee that the requistite number of cars would either be available in a timely manner or meet short line customers' needs or standards. On the contrary, it is reasonable to expect that larger railroads would provide their own shippers with premium equipment first, with old and obsolete cars supplied to short lines on an as-available basis, if at all. Further, if the short lines' connections also lack the market power to negotiate effective bilateral agreements, foreign line cars may be unavailable regardless of the time they are ordered, their condition or their price.

The cumulative effect of the Commission's decision will be to render worthless a productive asset critical to the competitiveness of short lines and their customers. In fact, the very solvency of many short lines—short lines that have relied on the system created by Congress and have incurred very real financial obligations—will be endangered. Contrary to the Commission's naive hopes, this sacrifice will not result in benefits for the national rail system or its users. Rather, it will deprive many shippers of their only access to rail service.

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[5] Such acquisition is consistent with the goals of applicable regulation. Section 11122 of title 49 of the United State Code requires the ICC to adopt car service regulations that "encourage the purchase, acquisition, and efficient use of freight cars."

[6] Ex Parte No. 346 (sub-No.8), supra (Slip Op. at 26).

IV. BASIC PRINCIPLES FOR SOLUTIONS

SLLC believes certain legislative changes consistent with Staggers Act principles can eliminate or mitigate the problems discussed above while enhancing the overall competitiveness of the transportation system. As a preface to discussion of possible modifications, we believe it worthwhile to set out certain basic principles that should guide formation of such changes.

A. The basic goals of the Staggers Act are valid and should be reinforced

The basic goals of the Staggers Act, particularly to reform federal regulatory policy to preserve a safe, adequate, economical, efficient and financially stable rail system, and to provide a regulatory process that balances the needs of carriers, shippers and the public, are valid and should be reinforced. Short lines, as aggressive and efficient small businesses making a significant contribution to the national transportation system, can only benefit from the consistent implementation of these goals.

B. To the extent possible consistent with preservation of competition and system efficiency, the marketplace should be the prime regulator of transportation services

Congress recognized in the Staggers Act that the marketplace is usually—but not always—a far more efficient regulator of transportation than is any governmental commission. Thus, the marketplace should govern relationships between parties for transportation services (whether among carriers or between carrier and shipper), unless the marketplace result would adversely affect competition or would foster unacceptable inefficiencies in the operation of the system. Congress recognized explicitly in the Staggers Act, as for example in the Lee Amendment to Section 217, that the marketplace may fail and anticompetitive behavior may ensue as a result of differentials in market power or other factors. As a result, Congress provided a form of residual regulation. As this testimony indicates, however, such regulation has not been implemented in a fashion that promotes competition, and, in any event, large carriers have in some cases taken other anticompetitive actions not contemplated by the Staggers Act.

C. When the marketplace fails, there must be mechanisms available that will ensure competition and system efficiency

No marketplace is perfect, least of all the market for rail services. A large rail carrier's control of property and the size of its operations confer substantial market power that can operate to the detriment of shippers and smaller connecting carriers. There must be effective and timely safeguards against abuse of such power, including clear guidance as to what constitutes abuse.

D. A prompt and efficient dispute resolution procedure is necessary; existing remedies are inadequate

Even with basic market mechanisms and clear regulatory restraints on anticompetitive behavior, disputes will arise between carriers regarding route closures, rates and other competitive practices. To resolve these problems a prompt efficient dispute resolution mechanism is needed. As presently constituted, administrative adjudication before the ICC is completely inadequate, in part because the basic standards are unclear and the range of anticompetitive behavior is misunderstood. Moreover, an antitrust action provides no remedy because it takes years to obtain a judgment and is prohibitively expensive. Only the most egregious and blatant actions can be thwarted effectively by an antitrust action. Antitrust law is simply unsuited to the practical day-to-day problems that require more immediate redress.

E. Applying the principles

As indicated above, the overwhelming concern of short lines is that they simply do not have sufficient market power to counter effectively an action of a large railroad that is either anticompetitive or produces a substantial operating inefficiency. While Chessie and Conrail, for example, can do battle in the marketplace over cancellation of joint rates or termination of reciprocal switching arrangements, short lines usually lack the leverage to participate effectively in such a marketplace solution. We have heard large carriers publicly represent that our traffic is important to them and that they will "deal" with us on matters such as negotiating empty return charges. However, we have also privately tried to negotiate with large carriers on such matters as contract rates, and found their public flexibility to be virtually non-existent in private. And, indeed, why should they be flexible? Small railroads are often at the mercy of their class I connections, with no practical recourse to the ICC or the courts to prevent the market power squeeze.

How can Congress ensure competition and efficiency where a significant market power imbalance exists? We suggests the following:

(1) Require the parties (carrier vs. carrier or carrier vs. shipper) to first resolve their problem between themselves. A party that has not attempted to deal in good faith should not have access to a "residual" regulatory alternative.

(2) Where a significant market power inbalance exists, either provide the adversely affected party the opportunity to have an alternative for intramodal access, or limit ability of the controlling carrier to abuse its power. For example, if a short line has only one class I connection and that connection is abusing its market power in refusing to offer competitive rates over joint routes, short line could be afforded the ability to reach alternative adjacent carriers either through trackage rights arrangements, terminal access or other means. Likewise, shippers should not be captive to a single carrier where another carrier can be permitted feasible access to that shipper, through reciprocal switching or other means. Alternatively, permit the restoration of competitive rates and routes by (i) allowing one party to a joint rate to meet single line rate competition by such means as "independent rate authority" as suggested by other witnesses at this hearing, and (ii) proscribing anticompetitive behavior against class III carriers in proportional rates, switching charges and reciprocal switching.

(3) Where negotiations fail and where a competitive alternative is not available, continue a residual forum with the ICC or its successor that will enable prompt resolution of such disputes. In so doing, Congress must establish—and we realize this is difficult but its importance cannot be overemphasized—clear standards for what contitutes anticompetitive behavior in this context or where the effect of an arrangement imposes unacceptable inefficiency upon the transportation system. These standards should then be applied by the ICC with reasonable dispatch and without unreasonable cost. We do not lack faith in Congress' ability to meet this task, as it has many times in the past in other contexts. We do lack faith in the ICC's ability to implement vague "public interest" standards such as that contained in Section 10705(e) of the Interstate Commerce Act regarding cancellation of joint rates.

As these oversight hearings move to more concrete proposals, we will offer specific language for this Committee to consider and will, of course, comment on the proposals of others. We are confident that by following the principles outlined above, solutions acceptable to all parties can be found. These solutions must be found quickly because the problems threatening short lines are becoming ever more acute for short lines. If short lines are provided the opportunity to compete fairly under a system of limited last-resort regulation, they will do so vigorously with significant and expanding benefits for the national transportation system.

On behalf of SLLC, I appreciate the opportunity to appear before the Subcommittee and would be happy to answer any questions you might have.

Senator DANFORTH. Thank you, sir.

Senator Long.

Senator LONG. Let me just ask you now, Mr. Gensburg, do you want us to amend that legislation or express ourselves to the ICC? Just what would you like for us to do about this matter now?

Mr. GENSBURG. I confess that I do not have a specific proposal to give to this committee right now. The Short Line Legislative Coalition will be working on that.

We feel that as to class III railroads we are in a different position from our much larger neighbors with whom we compete, and cooperation and, therefore, some mechanisms must be provided, either by legislation or revision of the boxcar deregulation decision, to protect the small railroads. The Staggers Act contains such provisions.

Senator LONG. Well, I am going to tell you a story that involves one of our former Senators, Lyndon Johnson, when he was the majority leader. I was serving with him and I went to him one day and I said: Now, Lyndon, this thing is a mess. It is just in one great big mess, and something has got to be done. Now what are you going to do about it?

He said: Don't bring me any more problems. I have got all the problems I can say grace over the way it is now. He said: If you have got some answers, bring me some answers. Problems? No more problems. Answers are what I need.

Now I hate to say it, but I find myself in that situation. I have all the problems I can say grace over. Now if you have some answers, that is what I am looking for. I would be glad to help any way I can. I can see you have a problem. Now do you gentlemen on this panel have an answer to suggest to that? Because as far as I am concerned, I think you have a problem.

What is the answer?

Mr. DONELAN. Senator, with respect to the Procompetitive Committee, our concerns are broader than the Grand Trunk or the Lamoille Valley, but our view, in answer to your question, is twofold.

First, we do think the Congress should admonish the Commission to enforce the Staggers Rail Act as you intended.

Second, we have been considering legislation and we would welcome the privilege of working with your staff in terms of finalizing language which we think will solve the problem.

Senator LONG. Well, I guess you were at yesterday's hearing. Were you here yesterday?

Mr. DONELAN. I was not.

Senator LONG. Well, I made the point yesterday on a different subject. We were talking to the investor-owned utilities. They said that as captive customers they were at the mercy of the railroads on captive coal and that the ICC had just taken the view that this so-called deregulation under the Staggers Act gave them carte blanche to do anything they wanted to do, to charge just as much as they wanted to for this coal, and that when they went to work to try to prove that these rates were unreasonable and that they were charging too much, the ICC took the attitude that it was the victim who had to prove that the culprit was engaging in misconduct, and that they did not even have the right to go look at the railroad's books to make their case, which to me is utterly ridiculous.

I mean, if you are talking about whether the rates are fair, we put language in the act that those rates have to be reasonable and that the ICC has to look into it, if there is any doubt about it. And then you make discovery in certain situations of why.

And here are the railroad and a public utility that is limited to a fair return on investment. I am talking about the electric generating companies. Until recently, the railroads were limited the same way, and certainly the electric companies well understand that you can rape the public mercilessly, if you have a monopoly over that customer, unless someone rides herd on you and tells you what you can and cannot do and how far you are permitted to go.

But certainly, if the utilities are permitted to maximize their profits, they can make twice the profits they are making in a hurry, or maybe 10 times—goodness only knows, but at least twice. And they are saying that the other guy should not be permitted to get away with highway robbery of the customer.

Their customer turns up, and they have to buy that coal. That is why they find themselves in that situation.

Now it is utterly ridiculous to me to hear the ICC say that they would permit discovery in some cases. Why should the railroads be permitted to hide the evidence in any case? So, it just seems to me that the ICC apparently wants the railroad to be making a lot of money in a hurry. That is all right with me for them to make a lot of money because they were not making much.

But, once they start victimizing the customers—and down my way they are in the process of victimizing them by the millions—when they start doing that, as an elected public official, I want to do something about it, and I had better start doing something about it if I want to stay in office, because people have a way of finding out whether their elected public servants are looking after their interests or not.

So, you have got a problem here, and I hope that we can help you work yours out, but we do like you to bring some answers over.

Mr. **Donelan**. We will be over to see the subcommittee staff.

Senator **Long**. I would just say to you what my friend Bob Curry of Oklahoma used to say. I want to help you, but I want you to make it easy for me.

Mr. **Burdakin**. If I might just add my support, first off, I appreciate the fact that you realize that there is a problem. We think, as indicated here, that it would be well for the Congress to tell the ICC what they really intended in the Staggers Act. Apparently, it is in the act. It is written, but apparently they misinterpreted for whatever purpose or goal they have, and that would require some additional legislation.

I would say there are many facets that focus in on this problem and different interests, of course. Let me just say that we would welcome the opportunity to work with any group providing or suggesting legislation. We do have some that we are discussing within ourselves, to be able to suggest legislation that will correct and address the problem. We appreciate the fact that you do perceive.

Senator **Long**. If I might make one more statement, Mr. Chairman. Your situation may be like the situation we are talking about with coal rates yesterday. We do not have to pass an act of Congress. It should not be necessary to send it down to the President. We already passed the act. There is plenty of language in that act for the ICC to protect the public interest here.

They have all the language they need. All they have got to do is construe it to the benefit of the public. You can compare it to the Constitution of the United States. The Supreme Court has all the language it needs in that Constitution to protect your rights, just depending on whether they want to do it or not. But they can construe it to your advantage or to the other guy's advantage.

It may be that that is your situation. Is that your situation or not? Can the act be so construed by the Commission to solve your problem?

Mr. **Burdakin**. I believe so, but our attempt and effort, as indicated, in what we have achieved in the seventh circuit court of having it remanding it back to the Interstate Commerce Commission. The court said it is not a meat ax situation, the ICC have got to look at each one of these route closings, and if it is appropriate, close it, but if it is not appropriate, do not close it.

But Conrail just took them all out. The issue has been put back into the ICC, but they are not listening to what Congress had told them in the Staggers Act.

Senator LONG. You know, we have been denied our legislative veto that used to give us some power to control or limit what some of those commissions do more than we can now, but it seems to me as though in trying to find the answer to it, maybe we ought to find a procedure where we could address some of those people out of office a little more easily. That might help solve the problem.

Mr. DONELAN. Well, if the chairman would bear with us, we are here as people who supported the Staggers Rail Act. However, we are concerned that the ICC has placed disproportionate emphasis on revenue adequacy, as the Senator has pointed out.

In addition, we are concerned about two remaining parts of the law. One is the protection of the shipper who is confronted with railroad market dominance. In these situations, a shipper has to look to the ICC as the surrogate, the substitute for market competition. The other part is that the Staggers Act is permeated with an objective that there should be vigorous, growing intercarrier competition. As these gentlemen have pointed out, the opposite has been occurring.

Senator DANFORTH. Gentlemen, let me see if I can get a handle on this from a layman's point of view. We are not railroad people in the Senate and, therefore, I think it is helpful to get things into everyday terminology.

Now you are speaking for the smaller railroads, is that correct, or people who rely on the smaller railroads? Is that the essence of it?

Mr. BURDAKIN. Mr. Gensburg and myself both are smaller railroads as compared to Mr. Wilkins, who is, of course, speaking from the shipper side and the lack of freedom that he has to route his traffic.

Senator DANFORTH. You are dependent on smaller railroads, right?

Mr. WILKINS. Or at least on a combination of smaller railroads, yes, sir.

Senator DANFORTH. Now in Mr. Wilkins testimony, in the summary of it, the following sentence appears:

> A number of railroads, including Conrail, Seaboard Rail System, formerly Family Lines, and Southern Pacific, have instituted a program of widespread terminating of joint rates and through routes, closing of gateways, and terminating or undermining reciprocal switching arrangements.

Now there are several terms of art in that sentence, but from the standpoint of a layman, what this means, as I understand it, is that the larger railroads are either shutting out the smaller railroads or making it very difficult for them to operate. Is that right?

Mr. WILKINS. That is correct.

Mr. BURDAKIN. Yes, sir.

Senator DANFORTH. Now is it fair to analogize the railroad situation to a tree, with branches going off the tree and twigs going off the branches, and to say that the trunk of the tree or the larger branches on the tree are somehow cutting off the twigs? Is that a fair analogy?

Mr. **Gensburg.** Most short line railroads have only one connection with the large carrier. The Lamoille Valley is lucky—it has three—but I would say the vast majority of short line railroads have one way to get their customers' products to the national railroad system, and that is on a large connection, and that is the only way they can do it.

Senator **Danforth.** So, in other words, there is a small railroad and it connects into a larger railroad, right?

Mr. **Gensburg.** Yes.

Senator **Danforth.** Now what are the large railroads doing to shut out the smaller railroads, just in lay terminology? What does this sentence mean? Do they just say well, we are not going to serve you any more, or what?

Mr. **Gensburg.** Let me give an example that happened in northern Vermont. It did not affect me; it affected one of the grand trunk roads, the Central Vermont Railway, which is a small railway. And it was delivering corn to a feed mill that was served by another large carrier.

The reciprocal switch rate was 5 cents a hundredweight, which costs about $100 a car. The service involved in that was just to push the car across the street, literally. What was happening was the large carrier was being what we would call shorthauled. It was losing the long haul on that traffic to a more competitive route, which was via the Grand Trunk-Western-Canadian National-CV Railway.

So what it did was it raised the reciprocal switch rate to 22 cents a hundred. Now it costs $440 to push that car across the street so that the Central Vermont could enjoy that traffic. I know of my own knowledge because we competed for some of that traffic that that same large railroad is hauling that same grain 90 miles on its own line to St. Johnsbury, Vt., and it is not getting anywhere near $440 for that 90-mile haul.

And I believe the reason it has increased the reciprocal switch rate is to freeze the CV Railway out of that traffic, and it has done so successfully—3,500 cars of corn a year moving over the Central Vermont Railway, and it no longer moves that way.

Senator **Danforth.** Now prior to the Staggers Act, did this kind of thing happen?

Mr. **Gensburg.** No. Reciprocal switching was fairly closely supervised by the Commission.

Mr. **Burdakin.** The reciprocal switching rate was by the Commission, a reflection of the actual cost that the railroad became involved in switching, how much it did cost to take the car in this particular case across the street and place it in the plant and then when the plant emptied the car then take the car and return it back to the delivering carrier. How much money did that actually cost that serving carrier.

And the reciprocal switch rate reflected that cost plus a normal percentage that you would expect for doing that kind of work. You certainly are not going to do it for free.

Senator **Danforth**. Mr. Gensburg says that what is happening is that the large railroad is intentionally shutting out the smaller railroads.

Mr. **Burdakin**. That is exactly correct.

Senator **Danforth**. Did that happen prior to the Staggers Act?

Mr. **Burdakin**. No, sir.

Senator **Danforth**. It did not happen prior to the Staggers Act?

Mr. **Burdakin**. No, sir.

Senator **Danforth**. Now is it the Staggers Act itself that creates this problem, or is it the functioning of the ICC, or malfunctioning of the ICC?

Mr. **Burdakin**. To me it is a misinterpretation of the Staggers Act. What the Staggers Act said was that you should not be doing business at a loss, and this is true, and we, of course, all support that. But, on the other hand, the ICC is not looking at how much of a profit. So as a result of that they just escalate whatever it takes to capture that traffic.

Let me just add one more impact of this. This happens to be on the end of the Richford Branch, which is about 20 miles and serves three or four little communities in Vermont. The only reason for that Richford Branch is for this traffic going to this grain elevator. Without that traffic to the grain elevator, the Richford Branch cannot survive. This is the impact that will occur from excessive reciprocal switching charges.

Mr. **Donelan**. Senator, would you indulge? I would like to make this point.

The problem of the small railroad is a very serious one. I think it would be a mistake, however, to assume that this problem is limited to the small railroads. From the point of view of the Pro-Competitive Committee, we are deeply concerned that larger railroads, with the objective of suppressing competition, have been cutting out other large railroads—for example, Conrail versus Chessie, Southern Pacific versus Atchison, Topeka and Santa Fe.

Mr. Wilkins, based on his practical experience, may want to add something to that.

Senator **Danforth**. Well, I would like him to, but we have got all these other witnesses and we are going to have a number of votes this morning as well.

Mr. **Donelan**. I just wanted to stress that the problem is far greater than just the small railroads. It is a very serious problem permeating all sectors of the rail industry.

Senator **Long**. May I have one more question, Mr. Chairman?

Senator **Danforth**. Yes.

Senator **Long**. When we try to do something about this, I assume we are going to be told that we are going back to all the complexities that existed under the ICC before and all the mischief that caused the rails to lose money.

I just wonder how much regulation this requires. I have heard about these cases before, the ICC taking years upon years to get something done. It seems to me that that what we are talking about.

The ICC ought to just appoint an examiner, let him take whatever evidence he thinks is necessary. I do not see why he could not get the fool thing over with in a few days, make his recommendation, and then they ought to back him. I mean, assuming he is a decent guy trying to do the right thing, they should not take forever to make up their mind that he did what appeared to be right.

Do you think we could do it expeditiously like that, or do you think it is going to require years and years of people arguing and submitting tons of briefs and all that kind of foolishness?

Mr. DONELAN. I think if this body speaks decisively, the ICC will cooperate.

Mr. BURDAKIN. If I may, the Staggers Act did exactly what you are asking for, Senator Long, in many of the areas, in putting down timeframes to the Commission that you must make a decision by such-and-such a time. What we are talking here on the route closings and the rate actions that have taken place, reciprocal switching, in our opinion it is not what Congress intended and what Congress put into the Staggers Act, and somewhere the ICC has to be told that.

Senator LONG. So your thought is whether they look at it for a day or a week or a month or a year, there is no way their decision could be so bad as without some decision in this case?

Mr. BURDAKIN. That is exactly it. Nothing could be worse than what is happening right now.

Senator LONG. Yes, I see.

Senator DANFORTH. Gentlemen, thank you very much.

The next panel, the Boxcar Lessor Panel—Mr. Texido and Mr. O'Dea.

STATEMENTS OF WILLIAM J. TEXIDO, PRESIDENT, BRAE CORP.; AND EDWARD M. O'DEA, PRESIDENT, ITEL CORP.

Mr. TEXIDO. Mr. Chairman, my comments concern the new car hire rules that were included in the new boxcar rules and how they affect rail car leasing companies, short line railroads, their shippers, and the railroad industry in general.

I am the president and founder of Brae Corp., which is primarily a transportation organization. We have an offshore supply vessel fleet out of Houma, La. We have a midwest trucking company, and we lease 11,500 rail cars, 6,500 of which are boxcars. We have a specific request to make of you today, and we think it is a specific solution to a specific problem.

Between 1975 and 1980, the organizations for which I was responsible, or had been responsible, raised over $900 million and introduced over 30,000 rail cars into the national system. This was done through the development of a new concept, which consisted of leasing rail cars to short line railroads that had significant outbound traffic and which had experienced a disasterous shortage of cars in the past.

That supply was inadequate in terms of quantity, quality and configuration. The money to acquire this equipment was raised based on car hire practices, regulations and laws which had been in effect since 1917. These laws had been strengthened through the new Interstate Commerce Amendment Act in 1966, the 4R Act in 1976, and the Staggers Act in 1980.

Consequently, the owners and the lenders felt confident that those rules would at least be around for the remaining duration of the debt which was required to obtain the equipment, namely 15 years. On May 2, approximately 3 years later, the rules were changed as a result of this recent new order from the ICC.

It is reregulation. It is new rules, and two important aspects are that once a car is made empty on a terminating railroad that emptying railroad no longer has to pay for it after 72 hours, and they can hold it until you are willing to pay 35 cents per mile to get it back—something similar to ransom, I would suggest.

The Commission's rationale for this apparently was that railroads could bargain between themselves and come up with equitable guidelines for the use and return of this equipment. Unfortunately, what they did not take into account is the short line railroad, and you have repeatedly heard testimony in the last 2 days that a short line is primarily an originating carrier.

He puts his products for shipment into cars that he owns or leases and very seldom has any foreign equipment on his tracks at all. Therefore, he is not in a position to bargain with these Class I's, and he is subject to the abuse of market power of the Class I railroads.

The idea that was fostered yesterday by Commissioner Gradison that the problem is going to be solved in 1990 by a shortage of boxcars in this country is just not reasonable. The payment on the debt of this equipment has to be made, if not monthly, at the very most quarterly. All of the rail car lessees and a large number of short lines will be bankrupt and out of business long before we get to 1990.

Let me give you a couple of examples in addition to those that have already been cited. The Meridian & Bigbee Railroad estimates that their cars will lose $300 per trip instead of earning $400, which is before debt service. Consequently, they will lose their cars.

Weyerhaeuser and their six railroads feel the same, and George Weyerhaeuser personally will be happy to testify on the matter, if you inquired of him. What the Brae Corp. has found—Willis Kyle, the largest operator of short lines in this country, with 13, has 8 of them that will go bankrupt as a result of the loss of the railcars because he will lose the shippers' traffic because he no longer will have the equipment which he specifically got to meet the needs of that shipper and that product will now go by truck.

What the Brae Corp. has filed is a petition which asks the Commission to reconsider the new car hire rules as to boxcars owned or held under long-term lease by short lines that acquire those primarily for transportation purposes, namely they had a need and they could not satisfy the need.

The petition merely asks that the new car hire rules not be applied retroactively, in other words, grandfather those cars that were acquired prior to the issuance of the rule, and we ask the committee to encourage the ICC to provide this exception in the order, and that will solve the problem that I have outlined to you.

[The statement follows:]

STATEMENT OF WILLIAM J. TEXIDO, PRESIDENT, BRAE CORP.

My name is William J. Texido, and I am the President of BRAE Corporation. The purpose of my testimony is to focus this subcommittee's attention upon the injustice and irreparable injury that will befall a small, but critical, segment of the rail industry as a result of implementation of that portion of the Interstate Commerce Commission's May 2, 1983 Order which imposes new car hire regulations.

I. THE COMMISSION'S MAY 2 ORDER ON NEW CAR HIRE REGULATIONS

The Commission's May 2, 1983 Order is a broad-based reform of the government's regulation of boxcar traffic scheduled to become effective on November 7, 1983. The major part of the Order involved deregulation of the shipping rates for commodities shipped in boxcars. BRAE does not object to the commodity rate deregulation aspects of the Commission's Order. BRAE is, however, deeply concerned—as are many shippers and short line railroads—with the new regulatory provisions concerning car hire—the 35¢ per mile empty return charge, and the storage reclaim charge. For BRAE, for many short line railroads, and for many shippers securing reconsideration of these new regulations is literally a matter of economic survival.

II. BRAE CORP.

BRAE was founded in 1977 at a time when the nation was in the throes of one of its most acute railcar shortages. The BRAE Corporation is now a diversified transportation company which in addition to its other operations owns, leases, or manages 6,500 modern boxcars most of which are specially equipped to suit particular shipper needs. BRAE is headquartered in California, and has more than 1,200 employees in 40 states. Our shareholders are scattered throughout the nation.

To protect its employees, shareholders and investments from the devastating effect of the Commission's new car hire regulations, BRAE has already filed with the Commission a Petition for Reconsideration, which has attracted widespread support, and a Petition for Review in the United States Court of Appeals for the District of Columbia Circuit. Numerous other petitions for review of the Commission's Order have also been made and the Court of Appeals has consolidated all petitions under the BRAE case. Additionally, BRAE filed a Petition for Stay with the Commission on July 15, 1983 seeking postponement of the implementation of the Commission's car hire rules for all boxcar shipments in Class III railroad boxcars which were acquired for use primarily by a shipper on the Class III railroad lines.

III. CONGRESSIONAL RESPONSES TO THE NATION'S RECURRING PROBLEM OF RAILCAR SHORTAGES

As the members of this subcommittee know, inadequate railcar supply has been a recurrent problem in this industry throughout this century. Historically, the major railroads have been unable or reluctant to invest the capital needed for new rail equipment. This failure to reinvest is in large part due to the extremely low return on capital earned by the rail industry as a whole.

Recognizing the need to encourage the acquisition of freight cars, Congress has passed numerous laws designated to stimulate capital investment. As early as 1917, the ICC was directed to establish car hire rules which would quarantee car owners a fair rate of compensation when their cars were being used by other carriers. This quarantee was subsequently strengthened and reaffirmed by the 1966 Amendments to the Interstate Commerce Act and the enactment of the 4R Act of 1976.

More recently, adoption of the Staggers Rail Act of 1980 reaffirmed the Congressional mandate of fair compensation for car hire. The Administration's original rail deregulation bill proposed that the section 11122 of the Interstate Commerce Act which guaranteed fair compensation for car hire be repealed outright, and that rail carriers negotiate per diem rates, either on an industry-wide or individual basis. Congress emphatically rejected this proposal. Congress did repeal the existing incentive per diem charge, but left intact the 4R Act mandate that the Commission's regulations "shall" encourage the purchase, acquisition and efficienct use of freight cars," and that the rate of car hire compensation "shall" be determined by considering, among other things, a fair return on costs including current costs of capital. The Conferees on the Staggers Rail Act emphasized in their report that in any event, the rental rate for rolling stock "should be sufficient to pay an adequate return on investment."

The Staggers Rail Act, then, directed that any Commission regulations establishing car hire rates *must* allow rail car owners fair compensation for the efficient use of their cars. This is a statutory standard that cannot be waived. Thus, at least since 1966, Congress has unswervingly declared that car hire compensation is to be set at levels that will provide a fair return on investment.

IV. PRIVATE INDUSTRY'S RESPONSE TO THE CONGRESSIONAL INVESTMENT INCENTIVES

Between 1975 and 1980, the management team at BRAE was responsible for the purchase of approximately 30,000 railcars representing over $900 million in rail freight equipment. An investment of this magnitude from outside of the existing rail system indicates how successful Congress was in encouraging investments in the rail industry.

Short line railroads which purchased their own cars and those companies like BRAE which helped to finance short line rail equipment designed for specific shipper needs, were attempting to meet specific and legitimate transportation needs of shippers on the short line railroad lines. They reasonably relied on § 11122's assurences of fair compensation. Boxcar owners—short line railroads or their lessors—entered into long term commitments premised on the statutory assurance of fair compensation.

The long term leases—often required by the financing institution—improved utilization, cut costs, and encouraged sound use of the leased boxcars. BRAE Corporation developed a concept of leasing new, specially equipped railcars to short line railroads for specific use by shippers on their lines. Short line railroads, frustrated by their inability to obtain either the quantity or quality of boxcars they needed from the connecting carriers, and often unable to afford the huge expenditures that purchasing boxcars entailed, welcomed the opportunity to lease the railcars they needed from BRAE. The resulting leasing arrangements link companys like BRAE with the interests of the short lines in opposing the Commission's May 2, 1983 Order.

V. IMPACT OF THE COMMISSION ORDER IN ITS PRESENT FORM

The long term leases have locked the lessee and lessor into a position now rendered untenable if the Commission's Order is implemented in its present form. As part of the May 2 Order deregulating the rates for commodities transported on boxcars, a majority of the Commission decided to drastically alter the car hire rules in two very important respects. First, carriers will have the unilateral authority to terminate car hire payments to car owners three days after cars have been emptied. Second, carriers will have the right to assess an empty movement charge of up to 35¢ per mile. Additionally, it is currently not clear from the Order whether carriers will, in addition, be authorized to assess storage charges against boxcars three days after unloading.

The party who is responsible for paying the newly imposed empty return charge under the lease will begin to lose substantial sums of money as soon as the order takes effect. In addition, the initiation of the storage reclaim charge will reduce the short line boxcar revenues by as much as one-half. The leasing agreements will not longer be mutually beneficial. Under these circumstances, BRAE simply could not remain in the rail business. The resulting withdrawal of the boxcars would leave many short line railroads without the equipment necessary to service their shippers.

Illustrations of the drastic and unfair economic consequences resulting from implementing certain aspects of the Commission's Order are replete in the record before the Commission's on BRAE's Petition for Reconsideration. Attachment A to this testimony contains a summary of statements regarding the adverse impact of the Commission's Order upon boxcar revenue per trip. For example, the Meridian & Bigbee Railroad—a short line railroad—compared the revenue earned on a typical boxcar shipment under present rules and under the Commission's new car hire rules. By application of the Commission's Order in its current form, this short line determined that the revenue earnings per trip on each boxcar would fall from $404 to a net loss of $366. Obviously, when net revenues from boxcar use drop to negative figures the economics of the situation will simply force the immediate cessation of boxcar use by short lines.

The injury described above is directly contrary to the Congressional policy and the previously described statutory mandates relied upon by boxcar lessors and short line railroads. Whether the short line railroad purchased its own cars or entered into a leasing arrangement, a central element in that decision was the knowledge that the cars would earn a revenue stream that was relatively predictable. The car hire compensation rules in place since 1917 have required a railroad to pay the car owner for the use of that car every day, whether the car was moving or stationary, loaded or empty, so long as the car was on the railroad's line. Also, the short line car owner was fully aware that the amount that the car earned was fixed by ICC formula and was adjusted annually to reflect the cost of doing business. Thus, car owners properly relied upon Congressional policy and ICC regulations in making short and long-term investment decisions.

Car owners did, however, fully assume the normal business risks such as competition, economic downturn, or reduced utilization. What car owners did not foresee was the possibility of a major reversal in policy and regulations which would render already consummated boxcar leasing and purchasing agreements valueless. The Commission's failure to grandfather those short line boxcars already acquired or subject to long term leases constitutes a retroactive action which will not only deprive those boxcar owners of the right to earn a fair return on their investment, but will also jeopardize the investment itself.

Equipment lessors such as BRAE, most of which are already either bankrupt or in default of their debt agreements because of the economic downturn, will no longer be able to survive if the Commission's Order is implemented in its present form. As a result their cars will likely be withdrawn from service. Consequently, even those short line railroads which may currently be protected from the empty return charges by advantageous leasing agreements will be faced with cancellation of the leasing arrangements, depriving the short line and its shippers of the special equipment necessary to provide quality service.

Shippers dependent upon short lines will also suffer as a result of the Commission Order. There is an undeniably close identity of interest between most short line railroads and their shippers. Many of these railroads are owned by or are primarily dedicated to serving a few shippers. A threat to the financial health or existence of one directly imperils the other. The shippers will likely lose ready access to some of the newest and best designed rolling stock available today, and much of it was acquired with specific shippers in mind. Shippers utilizing short line boxcars not only benefitted from the previously described lease arrangements by having an available supply of cars, but in many cases these cars were specially designed to take maximum advantage of the existing tariffs, to minimize damage in transit, and to provide ease of loading.

The economic consequences of implementation of the Commission's order in November for owners of short line boxcars will be immediate and irreparable. Income that a short line boxcar earns will drop to levels far below what is necessary to service the debt on the underlying financing instrument. On an industry-wide basis, it is estimated that short lines which own or lease boxcars will lose $175 million in the first year as a result of the Commission's new empty return charge. More importantly, this would severely undermine the long-standing creditability of the Equipment Trust Certificates and Conditional Sales Agreements which are the primary financing instruments for railroad equipment in this country.

VI. THE FLAW IN THE COMMISSION'S RATIONALE

The Commission's rationale for these dramatic changes in the method of boxcar compensation was based upon the expectation that the level of car hire payments would be "negotiated" between the railroads. What the Commission overlooked was that a short line boxcar owner will be substantially prejudiced because of the difference in bargaining power. A short line railroad will have little or no bargaining power or leverage with a Class I railroad. A short line railroad is typically a shipper-owned railroad which orginates traffic by loading its own cars. A short line, unlike a Class I line haul railroad, is often the captive of a single Class I railroad with which it must connect in order to move traffic off line. Short lines rarely have loads terminating on their lines that would provide a supply of empty foreign cars to use as a bargaining tool in negotiating with Class I railroads under the new regulatory scheme.

AS BRAE has demonstrated and as many other parties have agreed, the Commission's new car hire rules make the balance of economic power in many of these negotiations one-sided. Short line railroads have very little, if anything, to offer to a Class I carrier. The Class I railroad, on the other hand, has every incentive to return the car to the short line empty and extract the maximum 35¢ per mile empty return charge.

The Commission apparently believed that the new car hire regulations will make the national rail system more efficient, foster sound economic conditions in transportation, promote reasonable rates and conserve energy. Commission Order at p. 28. BRAE, the shore lines and many shippers disagree. We believe that, in many respects, the opposite is true. Under the current regulatory scheme, each railroad is encouraged to move foreign cars as quickly and efficiently as possible to avoid accumulating unnecessary car hire charges. The Commission's Order, on the other hand, allows a railroad to offset car hire with a storage reclaim charge and actually authorizes a carrier to collect 35¢ per mile for empty returns of boxcars. Thus, the Commission rewards inefficiency by its order.

VII. WORKABILITY PROBLEMS

The uncertainty created by the Commission's new rules provides another disadvantage and raises the question of whether the Commission's new requlatory scheme will ever be workable. I Have already mentioned the uncertainty relating to whether storage charges may be imposed by a terminating carrier. There are numerous other operational and equitable questions which must be answered before the Commission's Order can be integrated into day to day use. Although the Association of American Railroads is responsible for establishing car service rules which implement the Commission's May 2, 1983 Order, the AAR Committees on Car Service and Car Hire have already identified at least 13 critical ambiguities in the Commission's Order which must be clarified before the order can be made operational. Those ambiguities are listed in Attachment B.

Apart from the uncertainty resulting from the unknown aspects of the Commission's Order, it is an undisputed fact that the rail system as a whole is facing the prospect of massive numbers of negotiations pertaining to each route, each railroad, and perhaps each boxcar. It is doubtful that many short lines will be capable of assimilating the required volume of negotiations into an operational program without incurring substantial costs. As stated in a Reply Brief filed by the Mississippi Export Railroad Company:

"[T]here are 391 rail carriers operating in the United States subject to the rules promulgated by the Commission in this proceeding. The simple mathmatics of the potential number of contracts is staggering. If all the Class I and Class III carriers negotiated and entered into separate bilateral contracts with one another there would be a total of close to 100,000 separate contracts, many of which would would contain varying provisions and all of which would be subject to individual amendment. In the cases of investor involvement in car leases the total confusion through volume would be compounded." Clearly, the number of required negotiations and the consequential complexity of establishing an accounting system to trace cars for billing purposes will burden the short line railroads disproportionately.

VIII. INADEQUATE REGULATORY FLEXIBILITY ANALYSIS

Only three years ago, Congress passed the Regulatory Flexibility Act of 1980 requiring the agencies to consider the negative impact of each new government regulation upon small businesses. At the time of passage, Congress was concerned about the inequitable regulatory burdens which result when the agencies fail to focus upon the impact of the regulation on small entities. To prevent this, Congress mandated that all agencies undertake a "Regulatory Flexibility Analysis" in conjunction with each rulemaking.

In the instant rulemaking, the Commission appears to have failed to comply with the unambiguious requirements of the Act. The only evidence of any sort of regulatory flexibility analysis appearing in the administrative record is a one page conclusory statment incorporated in the final Commission Order. The administrative record does not evidence any examination of alternatives or modifications to the Order which would lessen the inequities upon short line railroads and their boxcar lessors. In fact, the Commission's most telling analysis of the impact upon small entities is that "short line railroads . . . may have good cause to be concerned about the near term effects of the proposal." The Commission merely concludes that the benefits to the public at large will outweigh the harm to small business, and I submit to you that that kind of generalized and unsupported statement is exactly what the Regulatory Flexibility Act was designed to prevent.

BRAE objects to the crippling impact that the Commission's Order will have on small business. BRAE has taken its case back to the Commission for reconsideration and to the courts for review. However, compliance with the Regulatory Flexibility Act has been left within the responsibilities of Congress—the Act explicitly excludes judicial review relating to compliance with the terms of the Act. BRAE therefore urges Congress to exercise its oversight authority in this regard and consider the consequences of the Commission's Order upon small businesses within the rail industry.

IX. CONCLUSION

BRAE Corporation's Petition asks the Commission to reconsider the new car hire rules as to boxcars owned or held under a lease of at least ten years duration by a short line railroad which acquired the boxcar primarily for use by shippers on its lines. Our Petition does not ask the Commission to reconsider its entire decision, and it does not detract at all from the deregulatory thrust of the Commission's decision. The rates for commodities shipped by boxcar would still be deregulated. The Petition merely asks that the new car rules not be applied retroactively, i.e. to boxcars already owned or leased by shortline railroads if the railroads acquired the cars for legitimate transportation purposes. The grandfathering of these boxcars would affect less than 12 percent of the national boxcar fleet and would provide the owners with the opportunity, but not the certainty, of earning a fair return on their investment.

More than 50 short line railroads have submitted formal comments to the ICC in support of the BRAE proposal. A list of all short line railroads impacted by the Order has been grouped by state and appended to this Testimony as Attachment C. The majority of the shippers served by BRAE have also expressed support for this Petition. Even the Department of Transportation has questioned the factual basis for the Commission's Order as it applies to shortline railroad boxcars which are used regularly or exclusively by shippers. The DOT's letter follows this statement as Attachment D.

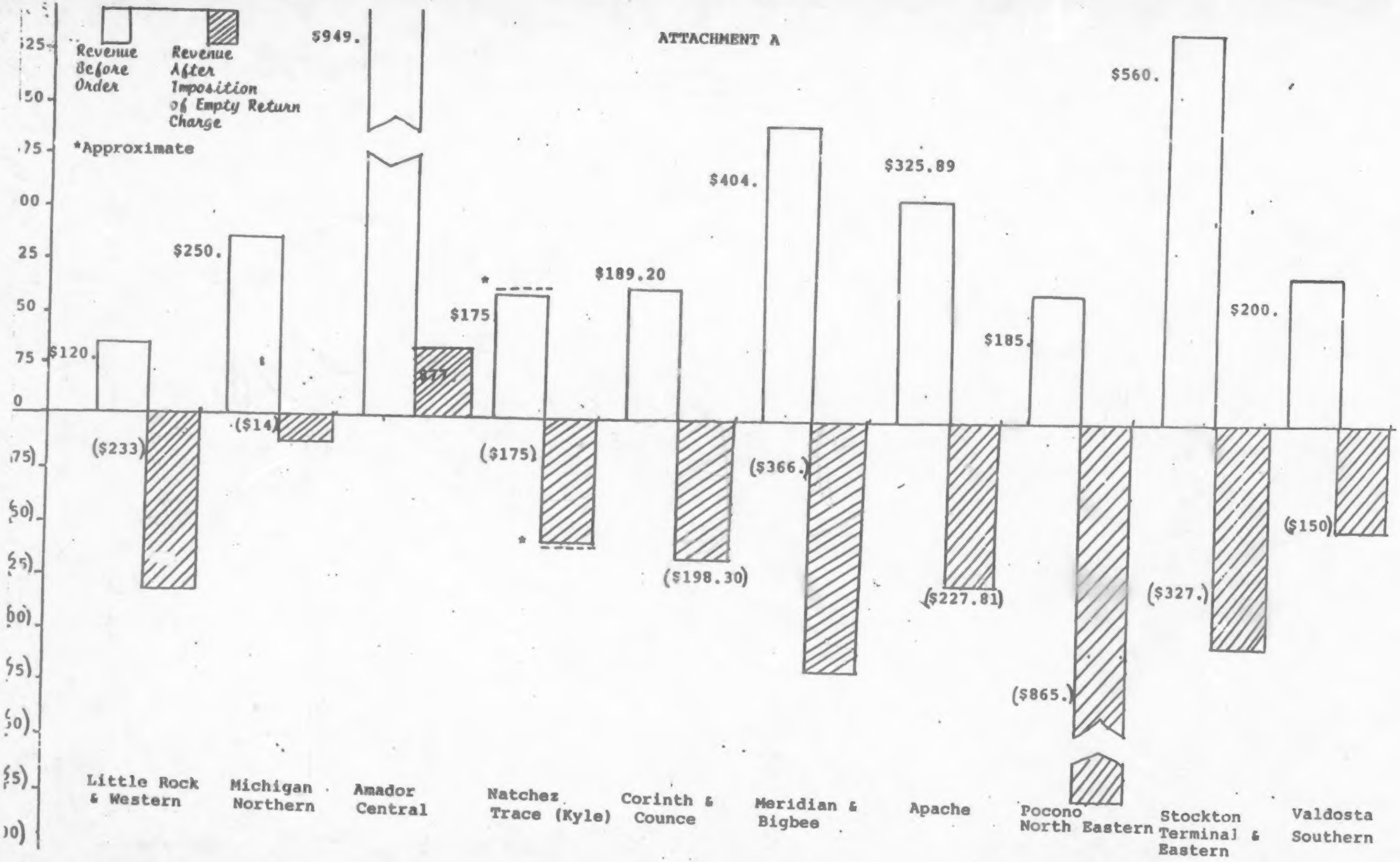
In sum, there is no justifiable public policy reason for imposing these new car hire rules retroactively on short line railroad boxcars. Transportation efficiency will be impeded, not benefited, as shippers are forced to use less efficient equipment or switch to trucking or barge transportation. We can cope with the day to day problems presented by a sluggish economy. Those are the risks of doihg business. We only ask that the Commission's changes not be effective retroactively upon previously consummated boxcar acquisitions and leases by short line railroads.

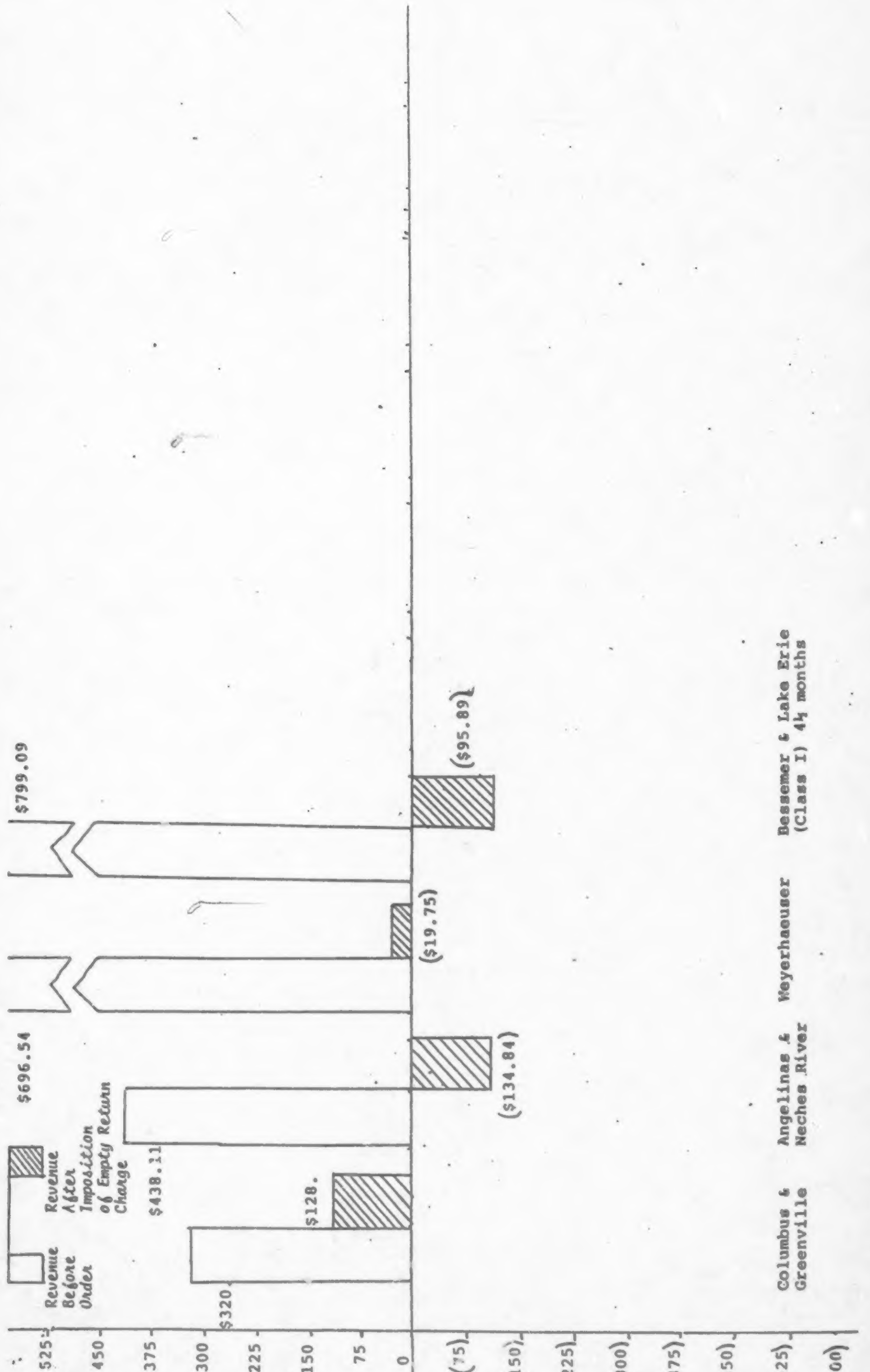
[Attachment A]

The following bar graph portrays the negative impact of the empty return charge upon the revenue earned per boxcar on each trip by various railroads which have replied to BRAE's Petition for Reconsideration.

This information was culled from those reply briefs which provided specific information pertraining to boxcar revenues on a per trip basis. The numbers are described in most submissions to be applicable to a typical boxcar shipment rather than providing the mathematical average boxcar revenues per trip.

ATTACHMENT A




525
450
375
300
225
150
75
0
(75)
(150)
(225)
(300)
(375)
(450)
(525)
(600)
Revenue Before Order
Revenue After Imposition of Empty Return Charge
$320
$128.
$438.11
($134.84)
$696.54
($19.75)
$799.09
($95.89)
Columbus & Greenville
Angelinas & Neches River
Weyerhaeuser
Bessemer & Lake Erie (Class I) 4¼ months

[Attachment B]

Association of American Railroads, Operations and Maintenance Department, Transportation Division, Committee on Car Service and Committee on Car Hire

MINUTES: JOINT SPECIAL MEETING, CHICAGO, ILL., MAY 24, 1983

(Attachment No. 3)

Questions

1. Do care hire payments to the owner resume once he has requested that his car(s) subject to reclaim be returned home?
2. If a car subject to reclaim is subsequently placed for loading by the holding road, does car hire resume at the time the car is moved from storage or the time of actual placement?
3. Does the holding railroad have an obligation to notify the car owner at the time it stores a car? If so, when?
4. If a car owner has requested the empty movement of a car that is subject to charges, may the car owner specify the junction at or route by which it is to be returned? May a car moving under empty charges be diverted to a different destination by the owner?
5. When does the 72-hour grace period start? When does reclaim start and terminated?
6. If a terminating railroad loads a foreign car to another destination more distant from the owning railroad, does the car owner incur responsibility for any resulting reclaim or empty mileage charges?
7. With respect to assigned cars, is the car owner responsible for any empty movement charges incurred in returning the car to the point of assignment?
8. What is the impact of X-346 Sub 8 on tariffs providing for the return of appurtenances in assigned cars to point of assignment?
9. Does an intermediate carrier have the right to intercept an empty car and, following the 72-hour grace period, reclaim car hire? When would empty mileage charges apply under such circumstances?
10. Do empty mileage charges apply from the point where a car is made empty to the actual storage point on the holding carrier?
11. Are empty movements governed by CSR 2 subject to charges? Empty movements governed by SCO 90?
12. How can an intermediate carrier identify those empty cars moving at the request of the car owner subject to charges from those empty cars not subject to charges?
13. What is the impact of X-346 Sub 8 on Canadian and Mexican cars in the U.S.?

[Attachment C]

State by State List of Short Lines Which Own or Lease Boxcars

ALABAMA

The Atlanta & St. Andrews Bay Railway Co.
Meridian & Bigbee Railroad Co.
Terminal Railway Alabama State Docks
Hartford & Slocomb Railway Co.
Birmingham Southern Railway Co.

ARIZONA

The Apache Railway Company

ARKANSAS

Little Rock & Western Railway Corp.
Helen Southwestern Railroad Co.
Arkansas & Louisiana Missouri Railway Co.
Augusta Railroad Co.
Delta Valley & Southern Railway Co.
East Camden & Highland Railroad Co.

CALIFORNIA

Amador Central Railway Co.
Stockton, Terminal & Eastern Railroad
Sierra Railroad Co.
Kyle Railways
San Diego & Arizona Eastern
Yreka Western Railway Co.
McCloud River Railroad Co.
The Arcata & Mad River Railroad Co.
Camino Placerville & Lake Tahoe Railroad Co.
San Luis Central Railroad Co.

COLORADO

The Great Western Railway Co.

DELAWARE

The Maryland & Delaware Railway Co.

FLORIDA

Apalachicola Northern Railway Co.
The Atlanta & St. Andrews Bay Railroad Co.

GEORGIA

Chattahoochee Industrial Railroad
Valdosta Southern Railroad Co.
The Atlanta & St. Andrews Bay Railroad Co.
Hartwell Railway Co.
Sandersville Railroad Co.
Savannah State Docks Railroad Co.
St. Marys Railroad

IDAHO

Minnesota Dakota & Western Railway Co.
St. Maries River Railroad Co.
Valley & Siletz Railroad Co.

ILLINOIS

Cairo Terminal Railroad Co.
Waterloo Railroad Co.
East St. Louis Junction Railroad Co.
Manufacturers Junction Railway Co.
Toledo, Peoria & Western Railway Co.

INDIANA

Indiana Hi-Rail Corporation
Ferdinand Railroad Co.
Indiana & Ohio Railroad
Louisville New Albany & Corydon Railroad Co.
Illinois Central Gulf Railroad

IOWA

Cedar Rapids & Iowa City Railway Co.
Iowa Terminal Railroad Company
Keokuk Junction Railway
Keota & Washington Railroad
Iowa Railroad Company

KANSAS

Hutchinson & Northern Railway Co.
The Kyle Railroad Co.

KENTUCKY

Cadiz Railroad
TransKentucky Transportation Railroad, Inc.
Tradewater Railway Co.

LOUISIANA

Arkansas Louisiana Missouri Railway Co.
Natchez Trace Railroad
Louisiana Midland Railway
New Orleans Public Belt Railroad
North Louisiana & Gulf Railroad Co.

MARYLAND

Canton Railroad Company
Maryland & Delaware Railroad Co.

MICHIGAN

Michigan Northern Railway Corp.
Escanaba & Lake Superior Railroad Co.
Hillsdale County Railroad Co., Inc.
Lenawee County Railroad Co., Inc.
Detroit & Mackinac Railway Co.
Port Huron & Detroit Railroad
Tuscola & Saginaw Bay Railway Co.

MINNESOTA

Minneapolis, Northfield & Southern Railway Co.

MISSISSIPPI

Mississippi Export Railroad Co.
Meridian and Bigbee Railroad Co.
The Corinth & Counce Railroad Co.
Natchez Trace Railroad
Mississippian Export Railroad Co.
Columbus & Greenville Railway Co.
Mississippi Railway
Golden Triangle Railroad
Pearl River Valley Railroad

MISSOURI

Manufacturers Railway Co.

MONTANA

Butte, Anaconda & Pacific Railway Co.

NEW HAMPSHIRE

Berlin Mills Railway Inc.

NEW JERSEY

Rahway Valley Railroad Co.

NEW YORK

Aroostook Valley Railroad Co.
Fonda, Johnstown & Gloversville Railroad Co.
Lackawaxen & Stourbridge Railroad
The Louisiana & North West Railroad Co.
New York, Susquehanna & Western Railway
Genessee & Wyoming, St. Lawrence Railroad
Middleton and New Jersey Railway Co., Inc.
St. Lawrence Railroad

NORTH CAROLINA

Atlantic & Western Railway Co.
Aberdeen & Rockfish Railroad Co.
Laurinburg & Southern Railroad Co.
Graham County Railroad Co.

OHIO

Oh-Hi Rail Corporation
Youngstown & Southern Railway Co.

OREGON

City of Prineville Railway
Oregon & Northwestern Railroad Co.
Port of Tillamook Bay Railroad
WCTU Railway
Oregon Pacific & Eastern Railway
Peninsula Terminal Company
Oregon California & Eastern Railway Co.
Union Railroad of Oregon

PENNSYLVANIA

Peninsula Terminal Co.
Gettysburg Railroad Co.
Lake Erie Franklin & Clarion Railroad Co.
Youngstown & Southern Railway Co.
Upper Merion & Plymouth Railroad Co.
Pocono & Northeast Railway, Inc.
Maryland & Pennsylvania Railroad Co.
Montour Railroad Co.
New Hope & Ivyland Railroad Co.
Pittsburgh, Allegheny & McKees Rocks Railroad Co.
Octoraro Railway, Inc.

RHODE ISLAND

Providence & Worcester Railroad Co.
Warwick Railway Co.

SOUTH CAROLINA

Pickens Railroad
Greenville & Northern Railway Co.
Lancaster & Chester Railway Co.

TENNESSEE

The Corinth and Counce Railroad Company

TEXAS

Belton Railroad Co.
Roscoe Snyder & Pacific Railway Co.
Moscow, Camden & San Augustine Railroad
Sabine River & Northern Railroad Co.
Galveston Wharves
Angelina & Neches River Railroad Co.
Houston Port Bureau, Inc.
Texas South-Eastern Railroad Co.
The Texas Mexican Railway Co.

VERMONT

Claremont & Concord Railway Co.
Green Mountain Railroad Corp.
Central Vermont Railway, Inc.
The Clarendon & Pittsford Railroad

North Stratford Railroad Corp.
The Vermont Railway, Inc.

VIRGINIA

Norfolk, Franklin & Danville Railway Co.
Virginia Central Railway

WASHINGTON

Pend Oreille Valley Railroad
Columbia & Cowlitz Railway Co.
Seattle & North Coast Railroad Co.

WEST VIRGINIA

South Branch Valley Railroad
West Virginia Railroad Maintenance Authority

WISCONSIN

Marinette, Tomahawk & Western Railroad Co.
The Ahnapee & Western Railway Co.
Wisconsin & Southern Railroad Co.
Wisconsin & Western

[Attachment D]

U.S. Department of Transportation,
Washington, D.C., June 20, 1983.

Re Ex Parte No. 346 (Sub-No. 8), Exemption from Regulation—Boxcar Traffic.

Ms. Agatha L. Mergenovich,
Secretary, Interstate Commerce Commission,
Washington, D.C.

Dear Ms. Mergenovich: The Department of Transportation (DOT) is today filing a formal reply to the petitions for reconsideration of Sea-Land Service and Totem Ocean Trailer Express. The purpose of this letter is to address certain other issues raised for reconsideration, particularly those relating to boxcars which are used regularly or exclusively by a single shipper.

DOT is in fundamental agreement with the May 2, 1983 decision of the Commission. The decision advances needed deregulation, the benefits of which are outlined by the Commission at page 20 of its decision. In addition, the Commission has, we believe, properly dealt with the problem of empty, and therefore non-productive, movement of freight cars around the country.

Notwithstanding DOT's approval of, and agreement with, the Commission's decision, we do suggest that the Commission consider the advisability of a separate proceeding to deal with boxcars owned or leased by Class III railroads which are used regularly or exclusively by one shipper. This issue, which has been raised most forceably in the Petition for Reconsideration of Brae Corporation, applies to a relatively limited number of cars (Brae asserts the total is 11.6% of the present national pool). Separate treatment for these cars has, nevertheless, received considerable support, particularly from Class III railroads. The Commission itself acknowledges at page 26 of its decision that "Short line railroads, on the other hand, may have good cause to be concerned about the near term effects of the proposal."

Because DOT is not convinced that the evidence now before the Commission is sufficient to fully evaluate the exemption sought by Brae, we urge the Commission to consider a separate proceeding to deal with those boxcars owned or leased by Class III railroad and in regular or exclusive use by one shipper.

Our second suggestion relates to the empty car return problem. It is apparent to us, and we believe to the Commission also, that simple boxcar rate exemption would have little effect unless accompanied by a solution to the empty car return problem. In that regard, we suggest that the Commission's ruling be more specific than as set forth in its May 2 decision. For example, we believe that the Commission should state rules that will apply in the absence of bilateral car hire agreements. These rules would address such issues as (1) the maximum appropriate daily storage charge, (2) when the storage charge would end in the event that a request for the return of an empty car is received, (3) how, utltimately, must a car be returned (since the railroad holding the car is no longer paying per diem charges, there might be little incentive to return the car promptly even if no net storage charge is being levied), (4) whether per diem shall be paid during the car's return trip to its owner, and (5) under what circumstances would an owner be responsible for the car return charge of 35 cents per mile when the movement is directed by another party, such as the Commission.

Sincerely,

ROSALIND A. KNAPP,
Deputy General Counsel.

Senator **DANFORTH**. Mr. O'Dea.

Mr. **O'DEA**. Thank you, Mr. Chairman.

My name is Ed O'Dea, and I am the President of Itel Corp. rail division, which is the largest independent boxcar leasing company in the United States. We own 14,000 boxcars and additionally have residual ownership rights in more then 10,000 additional boxcars. Those residual rights include remarketing rights when the leases on those 10,000 boxcars expire.

Additionally, we own four short line railroads. Three of these are class III railroads located in California, Alabama, and Wisconsin. We also own a class II railroad, the Green Bay & Western, in Wisconsin.

From our perspective, the boxcar exemption ordered by the ICC will undoubtedly cause enormous harm. It is wrong in principle because it denies the fundamental rights of private ownership and it shifts these normal ownership rights from the owning railroad to the using railroad.

It confers additional substantial and potentially abusive market power on large carriers when dealing with small carriers. Small railroads are urged, for example, to enter into bilateral agreements with large railroads when the fundamental concept of a competitive environment, which would include relative bargaining power, does not exist. Short line railroads have almost no bargaining power vis-a-vis large railroads because the short line is essentially a captive shipper without a modal alternative.

The ICC's boxcar exemption order may well guarantee that companies such as ours and other investors will never again respond to congressional incentives to meet a national need for freight cars. What return could be earned by our cars may be totally destroyed.

The ICC has issued new regulations under an exemption authority when there is nothing in the Staggers Act exemption provisions authorizing such regulations. Aside from that, the ICC has gone way beyond the limited kinds of exemptions countenanced by the act.

The ICC has virtually ignored the overwhelming response when vitally concerned members of the public pointed out the flaws in the boxcar exemption. Large railroads think it is a bad idea. Short railroads think it is a bad idea. Shippers think it is a bad idea, and trade associations have opposed it.

As for our short line railroads, one can only be shocked by the Commission's statement that short line railroads may have good cause to be concerned about the near-term effects of the proposal. Frankly, we are very concerned about the long-term effects. We foresee a return to the situation where the short line had to rely on large connecting carriers for boxcar supply.

This is a major reason why short lines embraced the boxcar leasing program in the first place, because it enabled them to provide a high class boxcar to its own shippers. Previously short line railroads struggled to obtain from the large railroads with which they connected an adequate number of suitable cars to serve their shippers. Nearly always the quantity of suitable boxcars supplied by large railroads was inadequate.

Additionally, we are extremely concerned that the exemption would wipe out the carefully prepared protections of the Lee amendment to the Staggers Act which was enacted to prevent large railroads from summarily canceling or surcharging their joint rates with short lines. Over 90 percent of the short line traffic moves on joint rates. While the Commission's implementation of the Lee amendment has been largely to ignore it, the exemption wipes out the Lee amendment protections entirely.

The exercise of this power to unilaterally cancel joint rates is so important that it could wipe out our own short line railroads, our lessees, and thus effectively our own railcar leasing business.

Finally and reluctantly, I must point out that the limited exception suggested by Brae Corp. is not the answer. Brae proposes a basically unworkable exemption which carves out a technical exception that is so limited in its application that I believe it would be of doubtful value even to Brae.

The Brae proposal fails to protect many of the cars owned by class III short line railroads. It gives no protection at all to boxcars owned by class II railroads which are only slightly larger than class III railroads. I do not believe it addresses properly the market power issues in establishing freight rates which are so important to the survival of the short lines, and I think there are some fundamental difficulties as to how this exemption could be fairly applied.

Thank you very much.

[The statement follows:]

STATEMENT OF EDWARD M. O'DEA, PRESIDENT, ITEL CORP., RAIL DIVISION

My name is Edward M. O'Dea. I am President of Itel Corporation's Rail Division with headquarters offices located at 55 Francisco Street, San Francisco, California, 94133. Itel Rail is primarily a boxcar leasing company. We own 14,000 boxcars which we finance by long term loans. We have principal and interest obligations on those loans. We have principal and interest on those loans to 1994. We placed our boxcars in general use in the railroad industry through leases with shortline railroads whose ownership marks they bear. As such, they are treated in the industry the same as any other boxcar bearing railroad ownership marks and became part of the national fleet. Accordingly, their use has been governed by the rules and regulations of the Interstate Commerce Commission and Association of American Railroads with respect to car hire and care service.

Additionally, Itel Rail has a residual ownership right in over 10,000 boxcars with the right to remarket (and responsibility for remarketing) those boxcars at the end of the lease term which is in most cases 15 years. Many of these latter 10,000 cars have been leased to Class I railroads. At the end of the lease term a strong potential market for their continued use under existing law and regulation would be with Class II and Class III railroads.

Itel Rail is the largest boxcar leasing company in the business—and also one of the first leasing companies to engage in the so-called shortline per diem boxcar lease.

Itel Rail owns four small railroads, i.e., Green Bay and Western Railroad Company, a Class II railroad serving Central Wisconsin; McCloud River Railroad, a Class III railroad serving Northern California; Hartford & Slocomb Railroad, a Class III railroad located in the state of Alabama; and Ahnapee and Western Railway Company, a Class III railroad located in Wisconsin. My testimony is in behalf of Itel Rail as well as our four subsidiary railroads.

The purpose of my testimony is to call attention to the enormous harm that will be visited upon Itel Rail and its small railroad subsidiaries if the decision of the Interstate Commerce Commission served on May 2, 1983, in the boxcar exemption proceeding is permitted to go into effect. Specifically, this is to urge and request this Committee to exercise its oversight powers over the administration and implementation of the Staggers Rail Act of 1980 by directing the Commission to withdraw its order of May 2 by which boxcar traffic would be exempted from regulation and by which new car hire and car service rules would be imposed for boxcars.

It may be helpful for the Committee if I describe the manner in which our business is conducted and how we got into the boxcar leasing business. In the early 1970's Itel Corporation was a leasing company dealing primarily in leasing large computers and ship containers to businesses. During this period the nation's chronic shortage of boxcars became even more severe. Boxcar shortages were seriously disrupting major areas of business in the United States. After having tried various "solutions" to this problem Congress, over time, changed the law in several respects to encourage investment in railroad boxcars by requiring the Commission's regulation of car hire to provide a fair return to boxcar investors. The Commission was directed to ensure that car hire rates returned to the boxcar owner its current costs of ownership, including the current costs of capital, labor, materials, and supplies.

In direct response to this legislative incentive Itel created its Rail Division and commenced financing and acquiring new boxcars for leasing purposes. Those boxcars were placed on "per diem leases" primarily with shortline railroads. Generally, a "per diem lease" is between the boxcar owning lessor and a shortline railroad pursuant to which the lessee shortline railroad gets free use of the boxcar while it is located on its own lines and the lessor earns its income from the daily car rental payments from other railroads using the car. Typically, the lessor receives all the daily rental payments up to a threshold level which triggers a requirement that the rental be shared with the shortline railroad lessee.

Itel's purchase and leasing of boxcars made a major contribution toward eliminating the boxcar shortages. These leases were welcomed by many shortlines because of their previous frustration due to inability to obtain an adequate number of boxcars from their connecting large railroads to serve the shippers located on the shortlines. Also, when boxcars were provided to the shortlines by their large connecting railroads, many of them had to be rejected and/or repaired before they were useable. This practice was not only frustrating but it was terribly expensive in terms of the switching cost associated with so many rejected and unsuitable cars.

Shippers were generally extremely pleased with the per diem leasing practice because it provided them with a source of boxcars that wer particularly suitable to their needs.

Our 14,000 boxcars are in excellent condition. They have been maintained with regular preventive maintenance and are still highly desirable for shipper use. Moreover, none of them is older than six years old, which compares with the average age of between 12 and 13 years for the nation's entire boxcar fleet.

We did an analysis in 1980 and determined that for the period 1975–1978 the boxcar revenue loadings on our 19 shortline lessees increased by 55 percent. During that same period revenue boxcar loadings on all the nation's Class I railroads grew by roughly one percent. We believe this clearly demonstrates there was a need for our equipment, that it contributed toward improving the economic situations of both the shippers and railroads involved, and that our boxcar leasing business established in direct response to the Congressional incentives worked and was in the public interest. The Commission appears to be of the view that such legitimate and public interest use of these and other incentives provided by Congress is somehow or other wrong and harmful as a "tax shelter".

In this regard, one of the arguments frequently cited is the belief that it has led to overbuying of railroad boxcars. This view is obviously predicated on the fact that large numbers of railroad boxcars have been in surplus supply for the last two years. This argument is without merit, however, which is shown by the fact that there are equally huge freight car surpluses in covered hopper cars, gondolas, and hoppers, all of which were acquired without any participation by the box car leasing companies. The point is that all types of freight cars are in high surplus (not just boxcars) and the reason is the present business climate.

The Commission's order of May 2 granting a broad unlimited boxcar exemption and issuing harmful car hire and service regulations is a dreadful overreaction to a problem, and one that would overturn a long history of successful car handling and car hire practice in response to representations made by Conrail. As a railroad that terminates at least four loaded boxcars for each one it originates, the exemption, and particularly the new rules, are direct efforts to financially assist Conrail at the expense of those who have acquired capital and assumed the debt and payment obligations for boxcars. We do not believe there is any public interest justification for treating companies like ours, who provided an innovative response to a legislative incentive to help solve a national problem, by pulling the rug out from under them as the Commission is doing in its May 2 decision.

The aspect of this action that is so mystifying is that the Commission has adopted a proposal of Conrail, endorsed on the basis of economic theory by the Departments of Transportation and Justice and supported by a handful of large shippers, while disregarding the arguments of a virtual avalanche of statements representing a broad spectrum of parties to be affected by the proposed exemption, all of whom told the Commission the boxcar exemption proposal was a bad idea and that its proposed car hire and car service rules were a mistake. As a matter of basic policy, any proposal which is so firmly and positively opposed by such a broad section of the many interests involved has to be suspect.

Let me turn now to a discussion of why Itel Rail and its subsidiary railroads are of the view that the Commission's order of May 2 constitutes a clear, serious, and present threat to our ability to compete.

The fundamental overriding defect in the Commission's order is that, instead of deregulating car hire, the Commission adopts new regulation that transfer the control of boxcars any from the owner to the user. In addition, those rules also transfer control away from any impartial arbiter (such as the Commission or the AAR) and places it in the user. The battle for control of boxcars located on the lines of terminating railroads is not a new one. It has a long history commencing in the early 1900's when the problem was to facilitate interchange of boxcar equipment until the last 45 or 50 years when the problem has been to get the user to pay a fair amount for his use of someone else's car. Over the years the railroads, through industry organizations such as AAR, have dealt with this problem. When the AAR process faltered and car shortages continued to prevail, the ICC took more direct action and served as the arbiter. But now the Commission's order will remove both ICC and AAR, and make boxcars we and others own subject to the arbitrary control of those users who benefit from use of equipment. I cannot believe that the Commission has really done this thoughtfully nor that they have really examined the evidence and history related to this matter. If they had, I do not believe they could have been convinced that placing such control in the users of equipment owned by others is reasonable or in the public interest.

I find the power that the Commission is placing in the user of our equipment to be a reckless disregard of the rights of ownership. It also is a disregard of the need for a careful balancing of the rights between owners and users in the complicated circumstances of freight car interchange inherent in the common carrier national railroad system. As a starting point, it should be recognized that boxcar owners do not force equipment upon reluctant or unwilling users. The freight car user earns important freight revenue from the transportation service it provides using our freight car. Historically, the primary obligation for freight car ownership to meet the needs of shippers has rested with the origin carrier. The using railroad gets to use that investment in return for paying rental.

Under the Commission's new order it has provided regulations authorizing the freight car user to place an owner's boxcar in storage once it has served its purpose on the user's line and to hold it indefinitely until the owner pays the user a transportation charge to get it back. This is so even though the user has benefitted from our having provided it with a boxcar. What makes this still more difficult for the owner to swallow is that the freight revenue the user receives includes a factor to cover its average empty return cost. Thus, under the new rule the user is paid twice for the same empty boxcar movement.

Even more difficult to understand is the new regulation imposed by the Commission in this order authorizing the user railroad to charge the owner 35 cents per mile if the owner (or the ICC or AAR) requests its car to be returned empty to meet the needs of its own shippers.

The 35 cents per mile rate is confiscatory. Whether the 35 cents per mile is levied against the leasing company or its shortline lessee, it will be confiscatory and make it so neither of them can continue to provide cars for shippers to load. For example, a boxcar with a turnaround time of 20 days earning roughly $20 per day will earn a total of $400 for that particular move. If that boxcar moved 1,000 miles after it left the lessee's shortline railroad, its empty return charge at 35 cents per mile would be $350, leaving the owner with $50 of net revenue for the 20 day use of its $40,000 investment. This analysis assumes that the boxcar was earning per diem during each of the 20 days of that movement. Because of an ambiguity in the Commission's order it is not clear that the owner could collect per diem during the period of the return empty move. If no per diem is paid during the return empty trip, boxcars owners would pay more to the railroads which use their boxcars than they would receive from them.

When it enacted the Staggers Rail Act, I don't believe the Congress of the United States had any intention of granting such broad power to users of equipment and eliminating rights of owners. It surely did not intend through the exercise of its exemption power that the Commission would issue new regulations with such far reaching consequences on matters of this kind. We believe that this committee should exercise its authority to halt this kind of blind extremism. Such regulatory action makes a mockery of Congress and its authorization for exemption from regulation.

The Commission appears to believe that it has cured some of the other problems of its order by authorizing railroads to enter into bilateral agreements dealing with car hire and car service. I am somewhat bemused by this emphasis upon bilateral agreements because there is nothing new about it. Under the existing regulatory structure dealing with car hire and car service, numerous bilateral agreements have been entered. This has been to the benefit of both using railroads and owning railroads as well as leasing companies. They are supplemental of and work in correlation with the general car hire and car service rules, however, They are not a substitute for the whole car hire system.

Itel Rail has made numerous agreements with Conrail and other railroad companies granting them free days for the use of our equipment without charge in order to facilitate the reloading of such equipment on such railroads. This has resulted in the saving of large amounts of car hire that otherwise would have been payable by the railroads entering into such bilateral agreements. In the surplus boxcar economy which we are now suffering, such actions on our part are in response to the market and the need for adjustment. This is being achieved, however, without scrapping the system and in fact there is no need to scrap the system.

One of the reasons for the inappropriateness of bilateral agreements as a substitute for the system is the sheer number of parties that are involved. There are over 375 individual railroad companies in the United States, most of which own some railroad boxcars. Each individual railroad owner would have to execute agreements with every other railroad potential user of its boxcars. This represents a massive administrative nightmare with an undue amount of complexity and waste of time. Not ony will those agreements have to be initially negotiated and executed but they will have to be regularly updated and changed. This is particularly so if, as the Commission and Conrail seem to think, boxcar hire is a free market rate that will change regularly as demand for boxcars changes.

There is no way a small railroad can engage in such outrageous processes because of the manpower requirement, the paperwork and the administrative cost. We own four small railroads. Each of them would have to negotiate several hundred bilateral agreements in order for their cars to freely flow through the system. We have over 30 lessees. Each of them would have to execute hundreds of agreements in order to continue in business and have their boxcars capable of being used throughout the system.

Another important problem with bilateral agreements as contemplated by the Commission's order is that small companies like ours and our lessees lack any effective negotiating or bargaining power to use in negotiating agreements with the large railroads. For example, two large railroads can negotiate a reciprocal agreement for empty car mileage charges knowing that each moves enough empties owned by the other so that neither can be gouged. However, the shortlines have such short mileages that they have no such reciprocating bargaining strength.

Much of the comment related to the Commission's boxcar exemption order focuses on the problems of boxcar hire and boxcar service. An absolutely vital additional problem, however, is the adverse impact it would have upon the joint rates which are so essential to the continued success of small railroads. The boxcar exemption places our subsidiary shortline railroads as well as our lessee shortlines in grave jeopardy of having their joint rates arbitrarily cancelled. Over 90 percent of shortline railroad traffic is delivered off line to Class I connecting railroads. From this it can be seen that only a very minor portion of their business moves on their lines only. It was the recognition of this relatively complete reliance of small railroads upon joint rates that caused the Congress in enacting the Staggers Rail Act to include the "Lee Amendment" codified at 49 U.S.C. 10705a.

Conrail had initially proposed complete authority for any railroad to cancel joint rates. Because of the clear unacceptability of that provision it was promptly rejected in the legislative process. Section 10705a of Title 49 of the Code was enacted as section 217 of the Staggers Rail Act. It was a carefully developed compromise to permit joint rate cancellations in certain circumstances with special protection for shortline railroads. The Commission's order of May 2 in the boxcar exemption case wipes out that protection for the large portion of shortline traffic which moves in railroad boxcars.

This is of particular significance to shortlines because large carriers are getting larger and are taking extensive actions already to assure that the traffic which comes to their line stays on their line for the longest possible haul. These actions are accomplished by various stratagems including the cancellation of existing joint rates, the adoption of reduced single line rates coupled with refusals to concur in reduced competitive joint line rates. The result is destructive of railroad competition rather than promoting railroad competitive and if it continues at current levels accellerated by exemption of boxcar traffic, many shortlines can expect their businesses to be drastically harmed.

Our Green Bay and Western Railroad, for example, is already having an increasingly difficult time competing with the long haul carriers because of these joint rate problems. A significant portion of GBW traffic is paper and paper products utilizing boxars and when the boxcar exemption goes into effect (if it does), GBW can expect joint rate practices that will reduce its participation to much shorter hauls and in some cases eliminate it entirely.

We are frequently asked how do we know that this would happen. The answer is simple. The intention of the larger carriers to retain all traffic on their lines for the maximum length of haul is painfully clear from the numerous actions they have already taken under other sections of the Staggers Act in dealing with joint rates. The end result of the elimination of competitive joint rates is to destroy competition rather than to promote it. A small railroad cannot compete if it does not have joint rates available to it for providing competitive service. Those rates must be at levels that will make it so shippers can utilize those routes without paying a penalty to do so. If boxcar freight rates are deregulated entirely under the Commission's exemption ruling, you can count on more joint rate cancellations against small railroads.

In my opinion the boxcar exemption is inconsistent with the intention of the Staggers Rail Act because it will harm railroad competition. Moreover, the Commission's action is arbitrary and not based upon the record that was before it. The Commission has certainly substituted its judgment for that of the vast majority of parties who participatd in the boxcar exemption proceeding. Over 200 parties took the time and made the effort to present evidence to the Commission on this important issue. Only a handful of those 200 supported the idea. The overwhelming response from the public was to tell the Commission that their proposed action was wrong, that it did not meet the Congressional standards, and that it would harm large groups of people dependent upon rail transportation either as customers or participants.

We are among that large group. Itel Rail, GBW, and our other rail subsidiaries participated fully at every stage of the proceeding before the Commission. We are not late comers to this process but saw the iniquity and inequity from the beginning as now. We told the Commission and every other interested party who would listen that its proposed boxcar exemption would harm the public and would have a serious harmful effect on our businesses.

Virtually all of the railroads both large and small told the Commission that the boxcar exemption was a bad idea. Conrail alone among railroads endorsed it fully. Except for a few large shippers, virtually all of the shipper groups and individual shippers told the Commission it was a bad idea. The federal government agencies that are large shippers by railroad (Agriculture and Defense Departments) told the Commission it was a bad idea. These were not mere argumentative statements but were supported by volumes of evidence directed to showing that the standards of the statute cannot be met and illustrating the potential harm that would result.

In spite of all of this, the Commission has substituted its own judgment and that of the Department of Justice and the Department of Justice and the Department of Transportation for that of the public.

In a fundamental way we do not believe this exemption is consistent with the rail transportation policy set forth in 49 U.S.C. 10101a. A major problem is that the boxcar exemption promotes disintegration of a national railroad system which is an important goal of the national transportation policy recited in several places. Vital to continuance of a sound and efficient national rail transportation system is a means by which freight cars can be used by others throughout the system with reliance upon payment for the use of those cars, their maintenance and upkeep, and relocation where necessary. This ability in the past has been one of the great strengths of the United States rail system. The boxcar exemption will eliminate that coordinated systematic approach and substitute a complicated, divisive, and unreliable series of a massive number of bilateral agreements.

One of the other tests of whether or not an exemption can be authorized under the Staggers Act is whether the exemption would be limited in scope. The boxcar exemption, encompassing something like 30 percent of the nation's carload rail traffic, is clearly not limited in scope and not even the Commission contends that it is. Where an exemption is not limited in scope (as this one is admittedly not) the Congressional mandate issued by the Staggers Rail Act was that an exemption is not to be granted if regulation is necessary to protect shippers against abuse of market power. Although the Commission requested evidence from the proponent of the exemption (i.e., Conrail) in a disaggregated form to permit it to make a finding on this issue, it is clear that no such evidence was presented. Since it has no reliable evidence of a kind and nature adequate to make such a finding, it has given no more than lip service to this Congressional mandate.

It is significant that Conrail is the only major railroad that seriously wanted this exemption to go into effect. From my perspective as the President of a corporation that provides equipment to the railroad industry and is directly involved in it as the owner of four small railroads, it is my observation that this exemption is specifically a "save Conrail" production inspired and motivated by Conrail and its owner and overseer, the Department of Transportation. Opponents of nationalization of the railroads for years argued that nationalization was bad because once the government becomes an owner it favors its creature over everyone else because of its interest and investment in it. This appears to be the case at the present time with Conrail. If this exemption is as it appears, a save Conrail exemption, it would seem that another less drastic way to save Conrail could be found. This one has clearly predictable antipublic policy effects and should be reversed. I find it hard to believe that Congress intended Conrail to be saved at the expense of little people.

This brings me to the question of what this Committee can or should do about the problem. In my opinion in the exercise of its oversight function the Committee should tell the Commission that this action exceeds what was intended to be authorized by the Staggers Rail Act and that it should withdraw this broad form of exemption. Otherwise, the Staggers Act's carefully prepared and negotiated joint rate provisions will be made a nullity and small railroad and the shippers they serve will be harmed.

The Committee should instruct the Commission that the exemption authority in 49 U.S.C 10505 is not to be used to issue car hire and car service rules and regulations but that 49 U.S.C. 11122 sets the standards for such regulation.

Perhaps the Committee in dealing with this problem could instruct the Commission to more thoroughly consider other alternatives to the boxcar exemption similar to those more limited in scope that do not entail such broad and pervasive consequences. We are not opposed to rate freedom for railroads but we do believe it must be exercised in ways that do not leave small railroads vulnerable and unprotected.

I am aware that one of the car leasing companies has expended considerable effort toward the promotion of a very limited exception from application of the boxcar exemption. If this exception were to be granted through the action of this Committee or voluntarily by the Commission we would make efforts in behalf of our leasing business and in behalf of our shortline subsidiaries to seek its protection. However, I cannot support such an exception because I believe it is so limited as to be of questionable overall value, certainly to our shortline railroads, and erodes the position of the legion of parties whose standing together can show that this boxcar exemption is unsound and not in the public interest. It does absolutely nothing to help small railroads protect against cancellation of joint rates. It does nothing to protect the many railroads including small ones whose cars were acquired in reliance upon the legislative incentives but would not be able to otherwise meet the standards for the exception.

In conclusion I would simply say that I am grateful for this opportunity to come before this Committee and explain why we at Itel Rail are so concerned about this matter. We sincerely hope that the Committee will be convinced by this oversight hearing that a real harm has been done by the Commission's implementation of the Staggers Rail Act of 1980.

I have concluded that the Commission is embarked upon a course of action dedicated to what it thinks of as deregulation without any equal dedication to staying within the limits of the provisions of the Staggers Act. I am equally convinced that it is too heavily influenced by solving the Conrail problem to the extent that it has no real interest in small railroads and companies like ours. In fact, its comments in the boxcar exemption decision show it is aware of the problems of the small people but that it simply does not care. A review of its Joint Rate Study submitted to Congress on November 12, 1982, reflects somewhat the same attitude.

We urge the Committee to carefully review the expressions of fear and foreboding presented by other withnesses as well as by us and to take the action necessary to direct the Commission to consider small entities as worthwhile members of society entitled to the protections Congress has set forth for them in the Staggers Rail Act.

Thank you.

Senator **Danforth**. Thank you.

Senator Long.

Senator **Long**. I do not think you need to go beyond this news release by the ICC Chairman Taylor with regard to this decision about which you are complaining. He says, just to pick out a word or two here that "the majority of deregulatory zeal has resulted in the imposition of an unworkable system on an unwilling public, and this is the kind of irresponsibility which can only serve the interests of those who are patiently searching for reasons to justify reregulation."

Now what are you saying here is that this was a matter of the Commission making a decision which victimizes the smaller people in the industry to the advantage of the larger people in the industry, and I believe, Mr. Texido, I am thinking of your situation.

Here we pass tax laws to encourage people to invest in these boxcars, and then we pass a law which was intended to bring about effective competition with deregulation. And what you are telling me is that the way the ICC is handling this makes possible the same type of old robber baron tactics that led to regulation in the first instance. Is that correct?

Mr. **Texido**. That is absolutely correct, Senator. The equipment was invested in for both Ed and I primarily by major corporations. They invested in that equipment, either Brae or Ford Motor Credit Co., and so forth. They invested in that equipment based on three rules that they had confidence would stay in existence—the investment tax credit, which was provided by Congress to induce investments of that type; accelerated depreciation, which was passed by Congress to induce investments of that type; and that these car hire rules which provided the revenue to make the transaction reasonable for a long period of time would be available.

What we are doing is we are changing the rules so that the revenue will no longer be available to those investors. If you changed investment tax credit or accelerated depreciation on a retroactive basis, you would have a civil war on your hands. So you are absolutely correct.

Senator **Long**. Well, does this not amount to a situation where the majority on this Commission has put the big railroads in the position that they can squeeze you people right on out of business and make you lose money every day you own those boxcars, and pick up your equipment for a pittance, a mere fraction of what they are worth?

Mr. **Texido**. That is absolutely correct, and that is exactly what will happen.

Senator **Long**. Thank you.

Senator **Danforth**. Now as I understand it, on the remedy the two of you disagree. Is that right?

Mr. Texido's proposed remedy is to remove the retroactive feature of the ICC's action, and to apply it only to new acquisitions of boxcars but not to existing boxcars. That is your remedy?

Mr. **Texido**. That is correct, because that is my business and that is the area that I am specifically concerned with.

Senator **Danforth**. Do you not agree that that is adequate, Mr. O'Dea?

Mr. **O'Dea**. I agree totally with any proposal that would remove the retroactive feature of the ICC's action for all existing boxcars. The problem is that Brae's proposal applies to only 12 percent of the boxcars in existence today. If you propose to grandfather all the boxcars that exist today, I will vigorously support that proposal.

Brae's proposed remedy does not apply to the entire boxcar fleet.

Senator **Danforth**. What is the distinction?

Mr. **Texido**. The difference is that we are a lessor of rail cars, as I have described to you, to short line railroads, and the exception that we propose will solve that problem for us. If I could, Mr. O'Dea has additional problems in that he has a class II railroad, for example, which is not included in our exception request, and he is concerned about that, of course.

We limited our exception to the specific requirements of our investors and our stockholders, because that is my responsibility and that does account for less than 12 percent of the national fleet, which we thought was reasonable.

Senator **Danforth**. Your position is that the boxcars were built in the first place under a financing arrangement which anticipated a foreseeable return on that investment, and when the rules are changed then that return is changed.

Mr. **Texido**. That is correct, with one exception—reasonable compensation. We assume the risks of the economy which in fact provides the return, and there has been no return for the last 3 years. Our rail car leasing division lost $2.5 million 2 years ago, $1 million last year, and we will lose over $3 million this year.

I am willing to assume that risk, because that is the risk of being in business. But when you change the rules and you change the compensation which that asset was led to believe you could expect to receive for at least the term of the debt, then we have got a big problem and we will go bankrupt, as will all of the other people, including the short lines that use the services of lessors.

Senator **Danforth**. Mr. O'Dea, your problem is not restricted to the financing arrangements.

Mr. **O'Dea**. My problem is that Bill Texido's boxcars that were purchased under financing arrangements which anticipated that Congress' promise of a "fair return" to boxcar investors would not be changed. If you fashion a remedy which specifically solves only Bill's problem, that remedy will not protect the owners of 88 percent of the national fleet, and I think frankly your responsibility is more than just Bill's, which is, as he says, just to his own investors and his own stockholders.

So the problems with the ICC Decision are much broader than Bill Texido suggests and cannot be solved just simply by exempting Bill Texiso's fleet. Although Brae's proposal would quite frankly, protect a good portion of our fleet, I do not think it deals with other major issues, which include the whole issue of the transference of ownership rights, from boxcar owners to boxcar users which, in effect, would happen under this 35 cents a mile empty car return charge and the storage provisions and I do not think it deals with some of the issues discussed by the earlier panel, the joint rate, issues.

Quite frankly, it may be that the flaws in the ICC decision are just so broad that the ICC should never try to deregulate a form of carriage such as the boxcar. Prior to this, deregulation has been done on a commodity basis.

Senator DANFORTH. So it is your view that the retroactivity approach, even if very broadly applied to all boxcars in existence as of a certain date, would not solve the problem?

Mr. O'DEA. That would solve the car hire and car service rule problems which are the 35 cents a mile return charge and the storage provisions. The retroactivity approach still does not deal with the fundamental problem of a short line railroad, which is not simply car hire for boxcars, but is the fact that a short line generates its revenue by carrying freight pursuant to joint rates.

Senator DANFORTH. So even if we applied the ICC's rule only prospectively, the effect of that on the small railroads is that since they would still have to own boxcars to ship their products out of wherever they wanted to ship them, they would continue to be at a competitive disadvantage with respect to the larger railroads? Is that right?

Mr. O'DEA. Yes.

Senator DANFORTH. It would solve the financing problem, the specific financing problem, but as far as the long-term competitive position or economic soundness of the smaller railroads, it would still be in peril?

Mr. O'DEA. If you were to apply the ICC's new car hire rules only prospectively, that would solve perhaps the car supply problem. Such a prospective application would also demonstrate recognition of the fact that all boxcars are not the same, a fact which is fundamental to this whole issue.

But it still leaves the short line railroads, which are essentially our customers and Brae's customers, somewhat imperiled because of the joint rate situation.

Senator DANFORTH. OK.

Senator LONG. Mr. Chairman, may I ask one more question?

Senator DANFORTH. Certainly.

Senator LONG. Mr. Texido, if we are going to provide a remedy for people who have boxcars for lease, why should that remedy not also apply to some newcomer entering the field who might want to rent boxcars and lease them in the future? Why should it be just a grandfather situation?

Mr. TEXIDO. Well, I do not know that it should not pertain to the future. But at least that prospective investor has the advantage of looking forward and seeing what will happen. Yesterday you may recall that Commissioner Gradison made some references to the fact that there might be additional boxcars acquired in this country.

I can assure you that I, for one, will never be buying any more boxcars with this kind of experience because my credibility will be completely undermined. I cannot imagine a whole lot of other people will either.

Senator **Long**. Well, the way it is going now, I can understand that. And I have voted for grandfather clauses in situations where we intended for somebody to get out of a business. I have voted for that, you know—we save those who are in it, but we intend for others to get out of it.

But I do not see why people should not go into the leasing business in the future. What is the reason that they should not?

Mr. **Texido**. Well, you certainly are going to discourage third parties from providing equipment to the national network of railroads, there is no question about it. By the same token, we have seen tax laws change prospectively, and we have dealt with that in a businesslike manner, and here we can make a logical decision as to whether we want to continue to participate in that business or not.

The fact of the matter is, though, we do not have to address this problem if this order is enacted, because we will be out of business. We will be bankrupt.

Senator **Long**. I understand that.

Mr. **Texido**. So that is why we are trying to solve the problem, sir.

Senator **Long**. Maybe that grandfather clause is the answer, but offhand it sounds to me just like a legitimate business that people should be permitted to go into in the future. I find that so many times businesspeople come to me and they want to save their business but do not worry about the other guy.

It makes me think about that old farmer who used to sit down with his wife for every meal, and he had the same blessing: God bless me and my wife, my son John and his wife, us four, and no more.

Senator **Danforth**. Let me say for the audience I would appreciate it if you would restrain yourselves from applause. There have been several attempts at applause the last couple of days, and it really is inappropriate.

Gentlemen, thank you very much.

Mr. Wilson.

STATEMENT OF ARCHIE L. WILSON, PRESIDENT, DIXIE CARRIERS, INC., AND CHAIRMAN OF THE BOARD, AMERICAN WATERWAYS OPERATORS, INC. ACCOMPANIED BY JOSEPH FARRELL, PRESIDENT, AMERICAN WATERWAY OPERATORS, INC.

Mr. **Wilson**. Mr. Chairman and members of the subcommittee, I am Archie L. Wilson, president of Dixie Carriers, Inc. in Houston, Tex. We are a barge company serving the inland waterway and offshore areas of our Nation. I am chairman of the American Waterway Operators and also vice chairman of the Water Transport Association, both national trade associations representing our industry.

I have with me today Mr. Joe Farrell, who is president of the American Waterway Operators, Inc.

We appreciate this opportunity to appear before you and present our views of the ICC's interpretation of the water carrier safeguards provided in section 707 of the Staggers Act. Congress designed these safeguards in order to protect shippers from potential monopolistic practices of the railroads.

Section 707 provides that nothing in the act shall be construed to allow the undermining of competition between railroads and water carriers. The intent of this section was clearly set forth in the conference report accompanying the legislation and explicitly states that section 707 applies to each provision of the Staggers Act.

Innovations under the act authorize rail contracts, exemption from rate regulation, and reduction in the regulation of rate discrimination. None of these innovations need harm water carriers, if balancing safeguards in the act are observed.

Competition can be undermined by manipulating rail rates so that a lower rate can be charged a shipper to an east coast port facility while the railroad sets higher rail rates to river locations for further movement.

In fact, this discriminatory practice was exercised by the railroads on export coal rates until last summer, when the Water Transport Association filed a complaint with the ICC against the Chesapeake and Ohio Railroad and the Norfolk and Western Railroad. Caught with their hands in the cookie jar, the railroads dropped their rates to the river ports.

Overall, we believe the ICC has given short shrift to section 707. We contend that only the Congress can direct the ICC to comply with Congress' clear intent and should do so forthwith. These transgressions constitute a hazard to the future of the waterway industry.

For example, the ICC found, as to rail contracts, that water carriers have no standing whatsoever under the Staggers Act. They ruled, it seems to us, in clear contradiction to conference report language which specifically states that section 707 applies to each section of the act.

They so ruled again, it seems to us, in clear contradiction of the act, which states that "essential terms" of all rail contracts should be made public, so that water carriers, agricultural shippers, and ports can seek remedies provided under the law. But the Commission rules do not provide sufficient information on rail contracts to protect all parties. The Water Transport Association has appealed this matter in the U.S. Court of Appeals.

Why should essential rail contract terms be scrutinized publicly when it is not the typical requirement for commercial contracts? There is a compelling reason to do so, one which Congress foresaw in its wisdom and why it chose the language it did. Most often, rail contracts are written in a monopolistic environment. This is precisely why public oversight is mandatory, else the railroads are free to make mischief for shippers, water carriers, and the public at large.

Another example relates to export coal. In his dissent of the Commission's decision to exempt export coal from rate regulation, ICC Chairman Reese Taylor blasted the rulings and warned that the railroads could effectively eliminate barge participation in export coal traffic by setting a prohibitively higher rate for coal movements to the water-connecting point vis-a-vis the rates established for all rail movements or by refusing to provide any service to the water-connecting points for export coal movements.

Insofar as the barge alternative is concerned, he stated, the export coal exemption is truly anticompetitive. Water carriers appear to be well launched into a no-man's land in which neither the procompetition provisions of the Interstate Commerce Act apply, nor does the certain remedy under the antitrust laws exist to correct the abuse of rail monopoly power.

We are headed toward a wrong without a remedy. We suggest completing the logic of regulation by amending the ICC Act to apply to transportation to procompetition principles of the antitrust laws. Railroads have long argued that they wanted to be treated as other businesses are treated. On the crucial issues of promoting competition, they cannot properly object to antitrust controls of monopoly practices. Water carriers would have no objection to such principles applying to them.

Mr. Chairman, we are ready to work with the subcommittee on specific legislative remedies to correct the subversion of the congressional intent in the Staggers Act. Thank you for this opportunity to speak on the subject.

Senator **Danforth**. Thank you.

Senator Long.

Senator **Long**. No questions.

Senator **Danforth**. Mr. Wilson, you gave us one example of railroads charging different rates for shipment of a commodity. Was it grain?

Mr. **Wilson**. Coal.

Senator **Danforth**. To the coast as opposed to the inland waterways.

Mr. **Wilson**. Yes, sir.

Senator **Danforth**. Was there any basis, to your knowledge, of that price differential?

Mr. **Wilson**. The basis was to encourage the coal to move to, in this case, Norfolk, Va., so that the railroads would have the full transportation of that product. They wanted it; they so testified.

Senator **Danforth**. So if the coal were shipped to the coast, it would be a longer haul as far as the railroad is concerned?

Mr. **Wilson**. Yes, sir. And as is often the case, the railroad has transfer facilities at the ports so they also want to be able to transfer it.

Senator **Danforth**. Now, are you a lawyer?

Mr. **Wilson**. No, sir.

Senator **Danforth**. But you did or your industry did consult with legal counsel in this matter?

Mr. **Wilson**. Yes, sir.

Senator **Danforth**. Did they advise you that it was an antitrust violation?

Mr. **Wilson**. They advised us that it was against the rules involved in transportation. Antitrust laws per se really do not apply to transportation.

Senator **Danforth**. I do not know that. I mean, is that correct, or is that a matter of exhausting administrative remedies?

Mr. **Wilson**. I do not believe that you can get to the court. Generally the court, when you go them with a problem like this, they will remand you to the Commission and say that they really do not know anything about the cost involved in these various moves and go to back to the Commission and let them rule.

Senator DANFORTH. But you feel that one way or another, whether enforced by the ICC or by the courts, violations for discriminatory pricing or refusal to deal or various kinds of anticompetitive actions should be applied to the railroads?

Mr. WILSON. Yes, sir.

Senator DANFORTH. And that is the problem that you seek to have remedied today?

Mr. WILSON. Well, yes, sir. That is certainly one of them. As an example, if you exempt from regulation the rates on coal and you allow the railroads to make contracts on that movement of coal, and you do not make, not the rate, but all of the other terms of the contract, if you do not make that available to the public, no one has any access to information to determine whether they have been harmed, whether there are some anticompetitive clauses in those contracts that are unacceptable.

Again let me say we are not concerned about the rate. Our industry is prepared to compete with the railroads on rates. It is the terms of the contract. An example could be that a railroad that serves a coal mine might say we will give you a lower rate from the coal mine to Norfolk if you will give us some traffic that is over here on the Mississippi River going from St. Louis to New Orleans. That is anticompetitive practices.

The railroads have monopoly power in some cases if they are allowed to do that, if they are allowed to sign contracts, and the public has no knowledge of contract clauses.

Senator DANFORTH. Do they do that?

Mr. WILSON. Not now they do not, but they have the capability of doing it if all of the terms in the contracts are not made public. The ICC has not set sufficient rules to control the type of information we can get out of those contracts.

Senator DANFORTH. Thank you very much.

Senator LONG. I just want to ask one question about this. What you are saying now is that unless the law is so construed by the Commission to prevent the type of anticompetitive practices about which you are complaining you can have a situation where it may be 100 miles to bring the coal to the water point and maybe 800 miles to take it over a mountain range and down the other side, and maybe 800 is too much.

But they could charge you as much to haul that coal 100 miles as they would to haul it 800 miles over that mountain range. Is that not what you are talking about?

Mr. WILSON. Yes, sir, that is certainly true.

Senator LONG. Can you give me some idea of what the distances are you are really talking about?

Mr. WILSON. I cannot. I do not know that they are too different from the example you gave, except that it might not be 800 miles from the mine to the port.

Senator LONG. But the principle is the same?

Mr. WILSON. The principle is the same. There was an actual case—and if you want this information specifically we will supply it to you—where the railroad had a rate from the mine to Norfolk, had another rate from the mine to a river port for domestic consumption of coal, and another rate from the mine to the same river port for onward movement by water to the gulf port, and the rate between the mine and the river port was different in the latter two instances.

Senator **Long**. The reason I did not ask any questions in the first instance, Mr. Wilson, was that the problem you are talking about is as old as the existence of the railroads. It is almost as old as the railroads themselves.

They charge discriminatory freight rates and put the barges completely off the waterways for years. If permitted to do so, they will do it again, and obviously that is what they are going to do if we let them get away with it.

I am not here to criticize them for doing it. That is just like saying a tiger is going to eat raw meat if you make it available to him. If we do not ride herd on this type of thing and just let them put the people on that Commission who will go along with the railroads and what they want to do, they will do it just as sure as I am talking to you, no doubt about that.

Mr. **Wilson**. Human nature being what it is, they will do what they are allowed to do.

Senator **Long**. Frankly, the only possible remedy down in my part of the country—we would like to ship some of that coal out down our way—would be to tell the carriers that it is all right to own the barge lines. That way they might let something come down our way.

Mr. **Wilson**. If they chose in their wisdom to allow the barge line to continue to exist. That is entirely possible.

I would submit that the antitrust rules that would place treble damages on this kind of thing would go a long way to being a deterrent. Anybody faced with criminal charges for the officials of the company and treble damages, if it can be proven, would go a long way to deterring this kind of monopolistic attitude by the railroad.

Senator **Danforth**. Senator Exon, do you have any questions?

Senator **Exon**. Mr. Chairman, I have no questions of this panel.

Senator **Danforth**. Mr. Wilson, the record is going to be kept open for an additional 2 weeks, and if you have specific examples of what you consider to be predatory practices by the railroads affecting the barge lines, I would appreciate it if you could submit those for the record.

Senator **Long**. Mr. Chairman, just having studied a little bit about this matter in years gone by, I know that he can present you a whole library of data if you want to go back into the history of this practice.

Senator **Danforth**. Not a library, just a few examples.

Senator **Long**. The Library of Congress could probably provide you 100 volumes. Is that not right, Mr. Wilson? There is all kinds of things written about this particular subject matter.

Mr. **Wilson**. Yes.

Senator **Danforth**. Well, if you could provide some specific examples, no more than booklet size, I would appreciate it. Thank you, sir.

[The information follows:]

THE AMERICAN WATERWAYS OPERATORS, INC.,
Arlington, Va., August 5, 1983.

Re oversight of the Staggers Act.

Hon. JOHN C. DANFORTH,
Chairman, Subcommittee on Surface Transportation,
U.S. Senate, Washington, D.C.

DEAR M. CHAIRMAN: We respectfully wish to take this opportunity to submit additional comments to supplement the statement presented July 27 before your Subcommittee by Mr. Archie L. Wilson, President of Dixie Carriers, Inc.

As you requested, Mr. Chairman, presented below are several specific examples of railroad efforts to undermine competition with water carriers, contrary to the language and intent of Section 707 of the Staggers Rail Act.

As Mr. Wilson stated in his prepared testimony, in 1982 the Water Transport Association (WTA) filed a complaint against the Chesapeake and Ohio Railroad (C&O) and the Norfolk and Western Railroad (N&W) charging that the railroads set far higher rates on coal moving to points on the Ohio and Missouri Rivers for shipment to New Orleans for export than the rates charged on shipments moving to Baltimore or Newport News (ICC Docket No. 38802, *Water Transport Association* v. *The Chesapeake and Ohio Railway Co., et al*). This discrimination was so blatant that both the C&O and N&W agreed to lower their rates on coal destined for export through Gulf ports.

To demonstrate the disparity in rates: coal moves by rail from Rawl, West Virginia, to Kenova, West Virginia—a river port—for a distance of 77.5 miles. As a result of the WTA petition, the rate for that movement was scheduled to drop from $8.30 per ton to $5.57 per ton on metallurgical coal and to $6.10 per ton for steam coal.

Another example can presently be found on the Columbia River where the towing industry is currently suffering significant losses in grain tonnage due to substantial rate cuts by the Union Pacific and Burlington Northern Railroads. The Union Pacific reduced its grain haulage rates in February 1982 only in areas where it is in direct competition with towing operators on the Columbia River. The Burlington Northern followed suit, and both lines again greatly reduced their rates in June 1983.

The new rates, depending on the distance from a lower Columbia River port out of Colfax, Washington, a major grain area, were cut from 10 percent to 22 percent. Rates for three-and-25-car wheat shipments now are 41 cents and 31 cents per hundred weight, respectively, off from 49 cents and 40 cents in May 1983.

According to the *Portland Oregonian* of July 10, 1983, Union Pacific's public information officer said that the rate cuts were not intended to drive anyone out of business, but that the Union Pacific is just trying to regain the share of grain haulage market it lost to trucks and barges in the 1970s.

A petition filed with the ICC by Tidewater Barge Lines, headquartered in Vancouver, Washington, was rejected.

Mr. Chairman, clearly these are examples of predatory practices by the railroads, practices which are illegal under Section 707 of the Staggers Act. I have enclosed supplementary information regarding these cases which I respectfully ask to be included in the record.

Sincerely,

JOSEPH FARRELL.

[The statement follows:]

STATEMENT OF ARCHIE L. WILSON, PRESIDENT, DIXIE CARRIERS, INC., ON BEHALF OF THE WATER CARRIER INDUSTRY

Mr. Chairman and Members of the Subcommittee, my name is Archie L. Wilson, and I am president of Dixie Carriers, Inc., of Houston, Texas. Dixie is a member of the American Waterways Operators, Inc. (AWO) and the Water Transport Association (WTA). I am Chairman of the American Waterways Operators and I am also Vice Chairman of the Water Transport Association. The American Waterways Operators is the national trade association representing the barge and towing industry. The Water Transport Assocition is a trade association representing ICC-certificated carriers on the inland waterways in the coastwise and intercoastal trades and on the Great Lakes. Dixie hold an ICC certificate of public convenience and necessity.

Transportation of freight on the U.S. inland and intracoastal waterways is of vital importance to the nation's economy. Navigable waterways directly serve 41 states, affecting more than 90 percent of our population. Since the end of World War II, the volume of freight transported on shallow-draft waterways has tripled and now totals some 300 billion ton-miles of commerce annually.

Barge transportation is ideally suited to high-tonnage shipments of bulk commodities and fuels. Energy resources account for more than one-half of total waterborne commerce. In 1981, for instance, 26.6 percent of shallow-draft cargoes consisted of bituminous coal and an additional 28.1 percent was petroleum and petroleum products. Efficient barge transportation is critical, therefore, to the domestic supply of motor fuels, heating oil, and fuels basic to the steel and chemical industries and to the electric generating industry. At the same time, barge transportation consumes far less fuel per ton-mile of cargo hauled than do the railroads, airlines and trucks.

Barging makes a major contribution to the U.S. balance of payments. The steel industry, for example, depends upon barges for receipt of much of its coal, iron ore and other essentials, and uses inland waterways to ship to domestic markets steel products which compete with imported steel. Domestic coal moves from interior mines to coastal points for export as well as for domestic consumption, providing an alternative to imported oil. In 1980, barge shipments of grains and soybeans to coastal ports reached a record 40.3 percent of total U.S. exports of these crops. The competitive efficiency of the U.S. chemicals industry, of petroleum refining, and of other basic industries is likewise reinforced by utilization of the highly developed inland and intracoastal waterways system.

Jobs for countless thousands of Americans are provided in mining, manufacturing, processing, construction and agri-business, enterprises which are heavily dependent upon waterway transportation. Waterway benefits are widely diffused. Trucks and railroads gather crops throughout the interior farming regions for transshipment at river terminals and carry loads of fertilizers, farm chemicals and fuels. Electricity generated from waterborne fuels is transmitted long distances to inland service areas by high-voltage lines. Many states and regions rely on the availability of waterway transportation to spur industrial growth. Barging is a major factor in this nation's economic activities.

Let me say that we appreciate this opportunity to appear before you and present to the Subcommittee our views on the ICC's interpretation of safeguards provided in Section 707 of the Staggers Rail Act. Congress designed these safeguards in order to protect shippers from potential monopolistics practices of the railroads.

Section 707 of the Staggers Act provides:

"With respect to the relationship between water carriers and rail carriers, none of the amendments made in this Act shall be construed to make lawful (1) any competitive practice that is unfair, destructive, predatory, or otherwise undermines competition and that was unlawful on the effective date of this Act, or (2) any other competitive practice that is unfair, destructive, predatory, or otherwise undermines competition."

The intent of this section was clearly and forcefully set forth in the Conference Report, No. 96-1430, filed September 29, 1980:

"The provision contained in this section, which qualifies each provision of each section of this Act, is designed to make clear that none of the provisions of the Act modifies existing law to make lawful a rate or practice that was unlawful on the day prior to enactment. Also, the conferees intend that this section allow water carriers to challenge practices that were unlawful as unfair, destructive, predatory, or otherwise undermined competition prior to enactment of this Act . . . The intent is that none of the amendments made by this Act is to be used to legitimize the undermining of rail/water competition."

Staggers Act innovations authorize rail contracts, exemptions from rate regulation, and reduction of the regulation of rate discrimination. None of these innovations need harm water carriers if balancing safeguards in the Act are observed.

However, water carrier traffic can be illegally diverted: By a rail contract in which a concession is tied into an agreement to divert barge traffic; by contracts which prevent water carriers from entering the bidding at the time the contract is open for bidding; by an exemption—such as the exemption of all export coal traffic or all export grain traffic—which would negate water carrier safeguards; by discrimination in rates which selectively undercut barge traffic while holding rates up elsewhere.

In addition, traffic can be diverted from the waterways by manipulation of rail rates so that a lower rate would be charged a shipper to East Coast port facilities and setting higher rail rates to river locations. In fact, this discriminatory pricing practice was exercised by the railroads on export coal rates until last summer when the Water Transport Association filed a complaint before the ICC against the Chesapeake & Ohio Railway and the Norfolk & Western Railway. Caught with their hands in the cookie jar, the railroads dropped their rates to the river ports, agreeing to charge rates on coal destined for export no more than those charged on domestic shipments moving from the same origin to the same destination.

Since passage of the Act, the ICC has often failed to recognize the significance of these Section 707 safeguards in protecting against the unlawful practices listed above.

I will not attempt to enumerate the various rule-making proceedings on rail exemptions, rail contracts, minimum rates and the long and short haul provision. How the ICC has acted tells the tale: it gives short shrift to Section 707. We contend that only the Congress can direct the ICC to comply with its clear intent and should do so forthwith.

These transgressions by the ICC constitute a hazard to the future of the waterways industry. For example, the ICC found, as to rail contracts, that the water carriers have no standing whatsoever under the Staggers Rail Act. They so ruled, it seems to us, in clear contradiction with the language included in the Conference Report, which specifically states that Section 707 safeguards apply to each section of the Act and that ". . . the conferees intend that this section allow water carriers to challenge (unlawful) practices . . ." They so ruled, again it seems to us, in clear contradiction with the Staggers Act stating that "essential terms" of rail contracts be made public so that water carriers, agricultural shippers and ports can seek remedies provided under the law. But, the Commission's rules do not provide sufficient information on rail contracts to protect all the parties.

The Water Transport Association has appealed this matter to the U.S. Court of Appeals for the Second Circuit. The WTA brief was also signed by Sea-Land Service Inc., the New Orleans Traffic and Transportation Bureau, Greater Baton Rouge Port Commission, Houston Port Bureau, Grain Transportation Consultants of the Pacific Northwest and the Traffic Board of the North Altantic Ports. Separately, eloquent briefs concurring were filed by the feed and grain industry's national association and by the Railroad Commission of the State of Texas.

Why should "essential" rail contract terms be scrutinized publicy when this is not the typical requirement for commercial contracts? There is a compelling reason to do so, one which Congress forsaw in its wisdom and why it chose the language it did in the legislation. Most often rail contracts are written in a monopolistic environment. That is precisely why public oversight is mandatory, else the railroads are free to make mischief for shippers, water carriers and the public at large.

If the court does not reverse the Commission, there will certainly be need for a legislative remedy in this case. A situation in which there can be abuses of monopoly power and no redress whatsoever under the Interstate Commerce Act must be corrected.

Another example relates to export coal. In his dissent of the Commission's decision to exempt from rate regulation rail transportation of export coal, ICC Chairman Reese H. Taylor, Jr. blasted the ruling and warned that "the railroads could effectively eliminate all barge participation in export coal traffic and thus adversely affect the New Orleans gateway either by setting a prohibitively higher rate for coal movements to the water connecting point vis-a-vis the rates established for all rail movements or by refusing to provide any service at all to water connecting points for export coal movements."

Chairman Taylor said that "the railroads have a powerful incentive to eliminate barges as a competitive alternative so that more and more export coal will be via all rail service, often to export coal facilities owned and operated by the railroads." Insofar as the barge alternative is concerned, he stressed, the export coal exemption can only be regarded as truly anti-competitive.

Certainly the Congress expected competition in the market-place to take over where detailed regulation was reduced. Dissatisfaction with deregulation is largely because competition is not working. There has been considerable dissatisfaction among many shippers with the ICC's interpretation of the Staggers Act, and some calls for "reregulation." The water carriers have long advocated going the other way. Water carriers appear to be well and truly launched into a no man's land in which neither the procompetition provisions of the Interstate Commerce Act apply, nor does the certain remedy under the antitrust laws exist to correct the abuse of rail monopoly power. We are headed toward a wrong without a remedy.

We suggest completing the logic of deregulation, by amending the Interstate Commerce Act to apply to transportation the pro-competition principles of the antitrust laws. Railroads have long argued that they want to be treated as other businesses are treated. On the crucial issues of promoting competition, they cannot properly object to antitrust controls of monopoly practices. Business lives with them.

What is needed are specific prohibitions of recognized anti-competitive practices, such as price discrimination and denial of access—plus a deterrant. The purpose of the deterrent is to promote self-regulation. It is the treble damage deterrent and criminal penalties that are at the heart of effectiveness of the antitrust laws in protecting competition. Water carriers would, of course, have no objection to having such principles apply to them.

Mr. Chairman, the water carrier industry is ready to work with this Subcommittee on specific legislative remedies to correct the subversion of Congressional intent in the Staggers Act, which was to promote competition.

Thank you for this opportunity to appear before you. I'd be pleased to try to answer any questions you might have on this subject.

Senator **Danforth**. Mr. Stepner, Mr. Anderson, Mr. Evans, and Mr. Gordon.

Mr. Stepner.

STATEMENTS OF PAUL STEPNER, TRANSPORTATION COMMITTEE, NATIONAL GRAIN & FEED ASSOCIATION; ROBERT ANDERSON, EXECUTIVE VICE PRESIDENT, NEBRASKA GRAIN & FEED DEALERS ASSOCIATION; TED EVANS, MANAGER OF TRANSPORTATION, USS AGRI-CHEMICALS, INC., ON BEHALF OF THE FERTILIZER INSTITUTE; AND DAVE GORDON, GENERAL MANAGER, RITZVILLE WAREHOUSE CO., INC.

Mr. **Stepner**. Mr. Chairman and members of the subcommittee, my name is Paul Stepner. I am chairman of the transportation committee of the National Grain and Feed Association. This statement is entered in behalf of the association and summarizes a more detailed statement that was previously submitted for the record.

The passage of the Staggers Act in 1980 has resulted in major changes in rail transportation policy by giving rail carriers new freedoms in decisionmaking on rail rates and services. All sectors of the economy have been affected, but none more noticeably than the movement of grain and grain products.

Although it is too early to judge the total long-range effects of Staggers, certain patterns are emerging in the act's implementation by the Interstate Commerce Commission that indicate that the Commission is acting in contravention of congressional intent by failing to protect the interests of shippers and receivers of products by rail. It is important, therefore, for Congress to clearly spell out its intent for rail deregulation by amending certain portions of Staggers.

To better assess the grain industry's vulnerability to rail carrier actions and decisions in the deregulated environment, the National Grain and Feed Association conducted a comprehensive study as to the effect of deregulated environment. This survey was designed to determine the amount of rail transportation being used by the grain industry and to determine the degree to which grain elevators are dependent upon a single railroad.

The survey found that all segments of the grain industry are heavily reliant on rail services. Of all grain shipped by survey respondents, 52.3 percent was handled by rail, compared to 27.2 percent by barge, and 20.5 percent by truck. These findings become even more significant when considering grain shippers that are dependent upon a single railroad.

The study found that of country elevators with access to rail service, 94.3 percent relied on a single railroad for this service. From a volume standpoint, 94.8 percent of the grain shipped by rail from these facilities is limited to service from a single railroad. A copy of the study and recommendations are hereby submitted for the record.[1]

The results of this study provides substantial evidence of the need for an integrated national transportation system based upon reasonable and equitable rates and services. It must also be recognized that the grain industry needs a minimum amount of regulation to protect grain shippers from potential abuses of market power.

For this reason, we believe there is a necessity to amend the Staggers Rail Act in order to promote greater competition in rail service, and we offer the following changes which are needed to protect shippers who are heavily reliant on those services.

First, require full disclosure of all economic terms of rail contracts involving agricultural commodities.

Second, apply a standard of reasonableness to market dominance by a rail carrier so that rail rates may be challenged as unreasonable at some level.

Third, require mandatory joint line rates and routes between rail carriers whose rail lines intersect and join.

Fourth, require adequate notice of rate changes.

Fifth, protect against discriminatory pricing and promote effective competitive and economical transportation services by and between all modes of transportation.

Sixth, establish new procedures permitting entry of additional rail carriers onto lines dominated by a single carrier.

Seventh, grant agricultural shippers the right to reciprocal switching at reasonable cost.

Eighth, establish a national system of compensation and use that fairly and equitably treats both carrier and shipper cars alike. And last, exclude grain and oilseeds from the exemption provisions of section 10505 of title XLIX.

While all of the issues mentioned are critical to the grain trade, preventing the ICC from completely deregulating grain carriers the highest priority of the National Grain and Feed Association. Thank you very much.

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[1] The material referred to has been retained in the committee files.

[The statement follows:]

Statement of Paul Stepner, National Grain & Feed Association

Mr. Chairman and Members of the Subcommittee: My name is Paul Stepner. Prior to January 1, 1983, I was Vice President of Transportation for the Pillsbury Company of Minneapolis, Minnesota. I am currently an exclusive transportation consultant for Pillsbury and am Chairman of the Transportation Committee on the National Grain and Feed Association. This statement is entered on behalf of the Association.

The National Grain and Feed Association is a voluntary association of grain and feed firms ranging in size from the smallest country elevator to the largest grain and feed complex, and includes merchandisers, processors, warehousemen, and exporters of a wide spectrum of grains and feeds. Its membership includes 1,250 direct memberships by individual firms and 46 state or regional grain and feed associations affiliated with the national association, including some 10,000 grain and feed firms.

The passage of the Staggers Act of 1980 and its subsequent implementation by the Interstate Commerce Commission has resulted in major changes in rail transportation policy. Particularly affected was the carriers ability to unilaterally decide rail rates and services for all sectors of the economy. Nowhere has the effect of this newly acquired market power been more noticeable than in the movement of grain and grain products.

The exercise of this market power has affected:

The level of rail rates and the notice period provided prior to rate changes taking effect.

The maintenance of joint rates and routes, as well as reciprocal switching arrangements—the lifeblood necessary to preserve an integrated rail system.

The criteria and proceedings used concerning rail line abandonments.

The use of rail contracts and the lack of effective rules requiring public disclosure of rail contract terms.

Although it may be too early to judge the total long range effects of this legislation on shippers and carriers alike, certain patterns are emerging which indicates that serious consideration be given to amending portions of the Staggers Rail Act.

One major point is becoming very clear. Most shippers perceive that the Interstate Commerce Commission is interpreting Staggers as a mandate from Congress for deregulation of the railroad industry. This perception exists because the ICC is no longer acting to protect the interests of shippers or receivers which should be one of its major roles. It is important, therefore, for Congress to clearly spell out its intent by amending certain portions of Staggers.

THE NGFA'S TRANSPORTATION STUDY

To better assess the effect of the implementation of the Staggers Rail Act of 1980 upon the grain and feed industry, the National Grain and Feed Association in 1982 conducted a comprehensive statistical survey. The survey had the additional objective of providing a sound basis for judging the extent to which economic interests of the grain industry would be vulnerable to actions and decisions made by carriers in a fourth-deregulated transportation environment.

The survey involved randomly selected grain elevators representative of all types and sizes of member firms. Of those surveyed, 151 were small companies and 13 were major companies. A total of 530 elevator facilities responded to the questionnaire, an 85 percent response rate. Of this total, 417 facilities were country elevators, 37 were subterminals, 46 were terminals, and 30 were located along inland waterways. Of the 530 facilities, 173 were capable of loading unit trains.

The survey of grain movements during the period of 1979–81 was designed to determine:

The amount of rail transportation being used by the grain industry.

The degree to which grain elevators are dependent upon a single railroad to ship grain.

THE STUDY'S RESULTS—A BRIEF OVERVIEW

The National Grain and Feed Association's study found that all segments of the grain industry are heavily reliant upon rail service, with most of the grain moving to market dependent upon rail service either totally or in part. The survey's results indicate that the merchandising of grain can be affected significantly by rail carriers' decisions and actions taken in the aftermath of the Staggers Act.

The statistical survey found that of all grain shipped by the 530 elevators responding to the survey, 52.3 percent was handled by rail compared to 27.2 percent by barge and 20.5 percent by truck. More than half of total grain volumes shipped by the surveyed elevators moved by rail. As would be expected, unit train shippers transported a greater share of total grain volume by rail (77.9 percent) than any other category of facility. Terminals, subterminals, and river houses shipped almost as high a percentage of total grain volume by barge as by rail.

While the study's results clearly demonstrated the grain industry's heavy dependence upon rail service, the extent of this dependence is even more dramatic when excluding elevators having no access to rail service. For elevators reporting access to rail service, rail movements comprise an estimated 58.5 percent of all 1979-1981 volumes. Of country elevators served by rail, nearly 60 percent of total volumes were shipped by rail. Of terminals, subterminals, and river houses served by rail, 56.6 percent of all 1979-1981 grain volumes handled were shipped by rail.

ELEVATORS DEPENDENT UPON A SINGLE CARRIER

These findings are even more significant when considering grain shippers that are dependent on a single railroad. The study found that 94.3 percent of country elevators with rail service relied on a single railroad for switching services and only 6.8 percent reported that traffic interchange with another railroad was possible. Further, from a volume standpoint 94.8 percent of the grain shipped from country elevators could only be switched by a single railroad.

For elevators served by railroads having unit train shipping capabilities, 88 percent had the switching service of one railroad and 15.4 percent report that traffic interchange with another carrier was possible. Of the grain shipped from these elevators, 89 percent could only be switched by a single carrier. For terminals, subterminals, and riverhouses served by railroads, 63.5 percent had switching service of only one railroad and 25.5 percent reported that traffic interchange with another carrier was possible. Of the grain shipped from these elevators, 78.6 percent could only be switched by a single carrier.

Impact on producers.—But the grain industry is not the only segment of agriculture affected by heavy dependence upon rail service. The survey's results also have important implications for producers, finding that an estimated 57.7 percent of all grain sold by farmers is shipped by an elevator dependent upon a single railroad.

RECOMMENDED U.S. TRANSPORTATION POLICY CHANGES

The results of this study provide substantial evidence of the need for an integrated national transportation system based upon reasonable and equitable rates and services. The National believes that while a return to a highly regulated rail environment is undesirable, the grain industry does need a minimum amount of regulation to protect shippers from potential abuses of market power given the industry's dependence on rail to move agricultural products to market.

Unlike the ocean freight, barge and truck markets, which have literally dozens of buyers and sellers involved in every transaction, the rail marketplace lacks the competitive elements that create a marketplace situation. It is clear that market forces alone cannot and will not provide agricultural shippers with adequate rail competition to protect the economic interests of all segments of the industry today.

For these reasons, we believe there is a necessity to correct portions of the Staggers Rail Act to promote greater competition in rail service and to protect rail grain shippers from abuse of market power resulting from the lack of entry and public right-of-way of the rail system. We believe the following changes should be made in the Act:

Require full disclousre of all economic terms of rail contracts involving agricultural commodities. The Staggers Act provides agricultural shippers with the statutory right to challenge the legality of contracts for reasons of discrimination, destructive competitive practice or failure of the railroad to fulfill its common carrier obligations. But the Interstate Commerce Commission has steadfastly refused to require the disclosure of sufficient information needed for a third party to determine if a challenge is warranted. The practical effect of this policy has been the use of contracts by carriers to hide their pricing actions from competitive pressures while at the same time denying the grain marketplace pertinent economic information as to the cost of transportation needed to trade grains.

Apply a standard of reasonableness to market dominance by a rail carrier, so that rail rates may be challenged as unreasonable at some level. Under current ICC criteria, it is virtually impossible to challenge the reasonableness of rates because of the Commission's definition of market dominance.

We propose that the determination of market dominance be changed so that on any route where the ratio of rate to variable cost is greater than five percentage points above the ratio which establishes the jurisdiction of the ICC, the railroad is presumed to have market dominance.

Require mandatory joint-line rates and routes between rail carriers whose rail lines intersect and join. Cancellation of joint rates and routes to those markets geographically within reach but inaccessible because of the lack of cooperation subjects shippers to abuse of market power.

In Ex Parte 427 National Grain and Feed Association offered the following proposals for legislative change in connection with joint rates and divisions.

1. The provisions of 49 U.S.C. 10705 and 10705(a) relating to through rates, routes, and divisions and joint rate surcharges and cancellations should be integrated.
2. Divisions disputes between carriers should be subject to arbitration.
3. Limit surcharges or joint route cancellation to one year unless the moving carrier either commences division litigation or arbitration within the year.
4. Carriers should not be permitted to cancel joint routes where insufficiency of divisions is advanced as a reason for the cancellation, unless it can establish that insufficient earnings are not a result of inefficient operations or poor management, unless it has previously been through a divisions case or arbitration on the same rates.
5. Congress should mandate the retention of existing joint rates as a condition to approval of railroad mergers, if it can be demonstrated that joint rates are utilized to any significant degree from or to points affected by the merger.

Require adequate notice of rate changes.—While the Staggers Act provides for 30 days notice before contracts become effective, the ICC recently ruled that contracts could take effect immediately upon filing with the Commission.

Protect against discriminatory pricing and promote competitive, effective and economical transportation services by and between all modes of transportation. Under joint ownership and control of transportation modes, it is essential that regulation continue for those segments of the transportation industry where freedom of entry cannot be achieved.

Establish new procedures permitting entry of additional rail carriers onto lines dominated by a single carrier. Currently, the rail industry is protected from new competition by the inability of competitors to enter given rail markets.

Grant agricultural shippers the right to reciprocal switching at reasonable cost. Currently, reciprocal switching arrangements often are cancelled arbitrarily, or switching rates frequently are increased to levels where they no longer are economically feasible. These actions are anti-competitive.

Establish a national system of compensation and use that fairly and equitably treats both carrier and shipper cars. Attempts to thwart competition through restrictions by carriers on the use and compensation of private hopper cars—which now comprise approximately half of all grain hopper cars—should not be permitted to continue.

Exclude grain and oilseeds from the exemption provisions of Section 10505 of Title 49. Conrail petitioned for exemption of boxcar traffic and certain railroads petitioned for exemption of export coal. National Grain and Feed Association has opposed these attempts for deregulation for two reasons: (1) those exemptions do not meet the criteria established under Section 10505 of the Title 49 and (2): If approved by the ICC, those exemption determinations will be used as precedents for rail carriers to seek exemption of grain. The ICC has approved these exemptions and the decisions are being challenged in the courts.

A number of railroads have expressed the desire to exempt grain from regulation. The National Grain and Feed Association is opposed to exempting grain from economic regulation by the ICC. Rail carrier interests point out that grain is exempt by water and truck and that regulation for rail carriers is discriminatory. It must be stressed that a shipper of grain by water and truck has freedom of entry, i.e. he can purchase his own transportation equipment or use a multitude of carriers which are available to him. Unfortunately, the shipper depending on rail service, in many instances, is captive to a single railroad and has no freedom of entry to obtain competitive rail services.

The intent of Congress to free the railroads from burdensome regulations did not include total deregulation. To my knowledge there are no industries, let alone common carriers, that are totally free to discriminate or engage in destructive competitive practices. To eliminate any doubt in the mind of the ICC in interpreting Section 10505 of Title 49, this section should be amended to exclude grain and oilseeds.

While the National Grain and Feed Association supports common ownership and control of transportation modes, it does so under the premise that a minimum amount of regulation is necessary for the rail transportation of grain and grain products, and that the preceeding changes in the Staggers Rail Act are necessary to protect the interests of shippers, receivers, producers, and carriers.

Senator DANFORTH. Thank you, sir.

Mr. Anderson.

Mr. ANDERSON. Mr. Chairman, I am Bob Anderson, executive vice president, Nebraska Grain and Feed Dealers Association. It is an 1,100-member, trade association comprised of 856 elevators. I also represent the Nebraska Fertilizer and Chemical Institute, which represents approximately 800 fertilizer and chemical dealers. I will try not to duplicate some of the testimony Paul gave.

We as an association do urge you to make improvements and refinements in the Staggers Act. We also feel there is as much a need today for the Interstate Commerce Act passed in 1887 as there was then. Additionally, we are in favor of the railroads earning a profit and we supported some of the changes that have come with the passage of the Staggers Act.

We do not think the Staggers Act has been implemented with some amendments added just before the final passage of that act for grain shippers and that is one of the reasons legislation and changes are needed at the Interstate Commerce Commission in their activities.

We do want to point out that there is a difference in grain movement, compared to other railroad shipments. One of these differences is the grain shipper or buyer of grain from the farmer has to know the price and the costs of grain that he is buying, and to do that he has to know the set transportation costs at a period sometime in the future. With the possibility now of these rates changing at anytime without notice, the elevator essentially has to back off what he could pay in purchasing the farmers grain because he is not sure when the grain railroad shipping rates are going to change or how much they are going to change.

The second thing is, as was pointed out by Paul, most of our shippers in Nebraska are captive shippers. Over 95 percent are served by one railroad, so they are at the mercy of that one railroad and the only competition to the railroad are trucks for short-hauling distances.

Pointing up those two items, the differences, for grain shippers: One, not knowing transportation costs at a future date and second, the idea that most grain shippers are captive shippers, I do want to stress the changes that are needed to the act and try not to duplicate the National Grain Association's testimony.

One of the suggested changes we think are needed to the Staggers Act is that a standard accounting system for computing all railroad costs the same way and this can be done by funding the Railroad Cost Accounting Principles Board as outlined in the Act.

Our main concern is the elimination of the secret contracts, and this problem can be solved by publishing all necessary shipping information. Other contract changes needed are: Not allowing these rates to be changed within 30 days; allow restitution to be given to a shipper on discriminatory contracts; allow a grain shipper to be able to buy out or by back a contract when a contract becomes outdated; define in the law so that small shippers can bargain collectively to seek a contract. And, finally I will point out if these contracts continue to be signed without full disclosure of information, essentially there is going to be less buyers for grain, meaning less competition in buying the farmers's grain. Consequently, there will be less of the advantage of the transportation, better bid due to a favorable contract, given back to farmers, since there will be less competitors.

I would also like to point up a couple of specific problems we run into in Nebraska on contracts. One is one railroad that has refused to enter into a contract, or has implied this, unless an elevator had an export grain facility.

Another thing we have run into on contracts is if a shipper ships in his own leased cars at a tariff rate, there is an advantage given under a contract to the buyer where he reaps part of that money, even though the shipper has invested in those cars and the buyer has not invested in those shipper-leased cars.

One of the other areas I would like to suggest that you look at changing in the act is the idea of encouraging the railroads before they abandon branch lines, that they try alternatives before closing a line: Apply a surcharge to each car shipped, second, to seek with the shippers to sign a cooperative agreement so that the shippers have a chance to save that line.

The third way is that the railroads should look at allowing the elevator to contract railroad services with the elevators, rather than doing it themselves, if this means less cost and it could save a line.

Another area for change is the antitrust provision under the Staggers Act which does cause problems in getting the railroads together to talk about rates, and maybe this is causing some of the difficulties we are running into now on switching costs and the other rates.

I tried to highlight those items that Paul did not touch. I thank you for the opportunity to talk with you. We do think the Staggers Act does need legislative changes. We also think that the Interstate Commerce Commission needs to apply some of the safeguards that you tried to address in the passage of the act, and we would be happy to work with the subcommittee and staff in any way.

Thank you.

[The statement follows:]

STATEMENT OF ROBERT L. ANDERSON, EXECUTIVE VICE PRESIDENT, NEBRASKA GRAIN AND FEED ASSOCIATION

I am Robert L. Anderson, Executive Vice President of the Nebraska Grain and Feed Dealers Association, a trade organization of over 1100 grain and feed firms within the State of Nebraska comprised of both independent and cooperative firms. The membership of our Association also comprises 856 grain elevators in the State of Nebraska. I want to sincerely thank this Sub-Committee for the opportunity to express our thoughts and opinions about the Staggers Railroad Act of 1980 during these Oversight Hearings and also appreciate the opportunity to express "suggested solutions" to the problems faced by Nebraska's grain trade due to this Act.

THE ASSOCIATION URGENTLY REQUESTS IMPROVEMENTS AND REFINEMENTS TO THE STAGGER'S RAILROAD DEREGULATION ACT OF 1980

The Nebraska Grain and Feed Dealers Association's Board of Directors, the Association's Transportation Committee and the membership of the Association for some time now, since the passage of the Staggers Railroad De-regulation Act of 1980 on October 14, 1980, have expressed their reservation and the difficulties they have encountered due to the passage of this Act. Some of the same problems I will talk about today, were once before predicted before a hearing of this Sub-Committee held on July 6, 1979, in Omaha, Nebraska. While Congress did try to address many of our concerns with amendments to the Act, the implementation of the Stagger's Act since then by the Interstate Commerce Commission (ICC) has not resolved these difficulties expressed by us at that Hearing. And, additional concerns have also surfaced since that time.

The Association has been in constant contact since October, 1980, with the Nebraska Congressional Delegation expressing the Nebraska grain trade's concerns and difficulties caused by the Act. This outcry would have been even larger if the grain faced a "merchandising of grain" versus a "storage of grain" environment. A stable volume of grain exports, the general national recession, and the increased competition by railroads for the reduced transportation of grain (surplus of transportation) held down the intensifying of many of the problems caused by the Staggers Act on our grain trade. However, there have been enough indication since 1980 that the Staggers Act does need to be immensely refined overall, and improved specifically.

The Association feels there is as much a need today for the Interstate Commerce Act passed in 1887 as there was then. Over the years there grew into existence an historical acceptance of the common carrier responsibility for the railroads to provide service to the public on responsible requests; but we also feel a "re-regulation" was needed for the railroads, as expressed by the Stagger's Act, for improving the railroads overall efficiencies, by making them more responsive to the forces in the market place. If these changes would have helped the railroads operate more profitably, while providing the services the shippers desired, the Association would still favor these endeavors. However, many of the provisions of this Act have been distorted and do eliminate or reduce the common carrier obligations to the grain trade today.

Financial figures furnished by the railroads will show rail rates have increased more than the consumer price index (CPI) in all years from 1975–1981 except for one. Grain rail rates during the last two years of this study period show an even higher average and the study shows the railroads earning on the average 5.1 percent in 1981 alone. It would appear revenues are adequate and might have been adequate even before the passage of the Act for most carriers.

My comments here today will not address the Act section by section, but directed more to the "definition of common carrier obligation, protection from discrimination, service, the protection of access to railroads for grain shippers, and the problems and suggested solutions to some of the Act's problems" needed now by the grain trade.

GRAIN MOVEMENTS UNIQUE WHEN COMPARED TO OTHER SHIPPERS

To better explain how grain shippers are in an "unique" position or are different from other shippers on railroads, I would have to outline on the one hand the grain marketing system and on the other hand the very few "market forces" acting as a checks-and-balances for grain shippers, since they are "captive" shippers. Please let me itemize my reasoning:

1. The unique grain marketing system

Grain shippers are very dependent on knowing the future costs of railroad transportation since the price offered to farmers for future sale is the transportation cost plus handling costs backed-off the Chicago Grain Futures price for that month of farmer future grain delivery. This "basis" (difference between the Chicago Futures Board price in a future month for a commodity and the cash price offered the farmer) must be solidly known or the farmer won't receive the highest possible price for his grain. Today, with the railroads' new abilities to change rates in a very quick manner within "zone of reasonableness" and below the "threshold" of their costs, there is no way for a grain shipper to predict future transportation costs. Grain shippers (marketers) are now in a high risk position where they can only protect themselves by widening their margins, since this information is not available and the rates may increase very rapidly.

2. Nebraska grain shippers are captive shippers

Of the 856 full-time elevator locations in Nebraska, only 37 are served by more than two railroads or 4.3 percent meaning 95.7 percent of elevators do not have market place "checks-and-balances" needed to keep each shipper's railroad responsive to his needs. Further, 103 elevator locations in Nebraska are served by trucking-only services or 12 percent of the various elevator locations; 753 Nebraska elevators are served by railroads, meaning only 4.9 percent are served by more than one carrier. These figures will show that the railroads do not face the competitive discipline of other transportation modes since railroads own and control their own right-of-way. These shippers do not have the competition and do need a regulatory framework to define their rights and provide the solutions needed to railroad transportation problems.

By understanding the grain marketing system, the need for contracting at a "known transportation cost" in setting prices, and knowing grain shippers are "captives" will quickly point up the disruption the Staggers Act brought to the grain railroad transportation system. Grain shippers cannot make marketing decisions, since they do not know transportation rates for future delivery. These same grain shippers operate on a closed-rights railroad and do not have the competition available from another railroad to keep their carrier responsive.

The grain shipper can look at building a larger facility on his railroad or on another railroad, but then he reduces his flexibility due to the costs of additional transportation and investments. Again, I can honestly say the Staggers Railroad Deregulation Act of 1980 did not take into account the uniqueness of the grain marketing system and the knowledge over 95 percent of all Nebraska grain shippers are "captive" to only one railroad.

PROBLEMS EXPERIENCED BY THE ACT AND SUGGESTED SOLUTIONS

While I can talk to you, hours on end, about the problems of the Staggers Railroad Act of 1980, it would not be fair for me to talk unless I also suggested solutions to the problems: Solutions which can be implemented by Congress to refine and improve the Act. While "secret contracts", as permitted under the Act are the major concern of the Association since these contracts disrupt the grain marketing system, there are many other items within the Act which will need to be redefined or changed unless this nation's efficient grain marketing system will be dismantled. Let me outline some of the problems and suggest solutions to them:

1. Define the rights and protections to the captive shipper

Small shippers need to be defined in the area of "market dominance", which is not recognized by the ICC, so the ICC cannot later apply a "geographic competition" or "product competition" application to erase any protections under the definition of "market dominance". This definition would give reasonable standards and give legal standing to captive shippers, so they can at least litigate protection for themselves in challenging unreasonable railroad actions.

2. Set up a standard accounting system for computing all railroad costs

To start out with, this can be done by funding of the "Railroad Cost Accounting Principles Board" as outlined in the Staggers Rail Act. It is very hard for a shipper to challenge a railroad rate if different railroads apply different costs for different commodities. The standardizing of formulas on computing all railroad costs for "revenue-to-variable costs" rate ratios for "threshold pricing" under the Act would be very helpful.

There are still many inequalities as pointed out by a USDA study on a 1979 instance of a 50-car export rate from Hastings, Nebraska, to the Pacific Northwest in shipper-owned cars. The rate for wheat was $1.39 per cwt and was only $.94 per cwt on feed grains and soybeans. There are other inequalities on mileage rates; for instance, the rate for single cars in various items in the same tariff: 300 miles (59¢–57¢ cwt), 340 miles (67¢–61¢ cwt), and 400 miles (77¢–70¢ cwt). These inequalities continue to exist in the grain trade on railroad rates today.

3. *Eliminate "secret contracts"*

Nebraska Grain and Feed Dealers Association feels strongly that "secret contracts" disrupt the interlocking grain marketing system within our State. While there can be many favorable reasons for contracts like: the steady volume movement of other commodities, increased speed of shipments to reduce inventory costs, the reliability of transportation, and other reasons, these contracts are being misused in Nebraska to disrupt the grain market place. Some of the related difficulties of these contracts are:

A. Full rate information cannot be acquired from the Interstate Commerce Commission, nor in a timely manner so a grain shipper can request a similar contract or to even know whether he is being discriminated against or not. All pertinent information needs to be disclosed on any contract filed at the ICC. The information presently being disclosed is not pertinent, or useful.

B. Contract rates can be changed within the thirty days by amendment and disrupt again the grain marketing process. An adequate rate notice and a public debate system with an incorporated arbitration of disputes could eliminate this problem.

C. Restitution should be given by the railroads on discriminatory contracts which is not provided in the Stagger's Act now.

D. A grain shipper should be able to buy out of a contract with a railroad, just like buying out of a grain purchase contract if market conditions change at a later time. This is not possible now.

E. It should be fully defined in the law that small shippers can bargain collectively with the railroads on grain contracts, but they'll need the rail cost information and the assistance of some public body to do this.

F. Any benefit received by the farmer now on contracts could be eliminated in the near future since only truckers and a few contract holders would be bidding on a farmer's grain, meaning less market place competition for a farmer's grain.

EXAMPLE OF PROBLEMS ON CONTRACTS BEING EXPERIENCED BY NEBRASKA'S GRAIN TRADE

(1) One of the railroads in Nebraska has been telling grain shippers they will not consider a contract with that grain shipper or group of grain shippers, unless they have an export grain loading facility. This practice would appear to be discriminatory and could eventually force some grain shippers out of business by controlling the grain market place when the contract destination-market is in high demand by artifically forcing the movement of interior (origin) grain to those few shippers holding the contract with the railroad.

(2) Exporters are capitalizing on other's investments in leased cars. Discounts are being given to grain exporters on the published tariffs since they have a contract and shipper, who is not under this contract, is being offered a 5¢ a bushel advantage under the tariff rates to ship grain to this exporter in the shipper's own private railroad cars. This 16¢ break per cwt given to the exporter on private railroad cars gives a 8.9¢ per bushel advantage, meaning the exporter receives 3.9¢ a bushel, even though the shipper has made the total investment in his own cars. This should not be allowed.

OTHER STAGGER'S DIFFICULTIES AND SOLUTIONS

1. *Compulsory joint-line rates and routes and switching charges between carriers should be required*

This would help keep the railroads in check-and-balance; and there should be a mandatory requirement on switching rules and costs. For example: one railroad charges $100 per car and another charges much less from the same origin to the same destination. The railroads should be required to keep reciprocal switching and to dissolve disputes over joint line rates through binding arbitration, at least, and the same on switching disputes.

2. Require ICC to enforce restriction on peak, seasonal, or demand rates

Even though the law outlaws this at the present time it is being abused.

3. Adopt new requirements permitting one railroad to operate on another railroad's line

If a shipper is a captive shipper and dominated by one railroad, this procedure could be followed after a railroad had turned down a shipper's request for gathering rates or other alternative proposals.

4. Encourage railroads to set up switching destinations in order to pool several rail cars and promoting other model transportation services

Truck-rail.

5. Require railroads to undertake positive alternatives before abandoning branch lines

In Nebraska in the 18 months previous to the passage of the Staggers Act, 37.81 miles were abandoned by railroads. Since the passage of the Staggers Act, 162.84 miles have been abandoned in the State through December 1, 1982. Whereby, an average of 25.21 miles per year were abandoned previous to the passage of the Staggers Act in Nebraska, an average of 54.28 miles is being abandoned each year since the Act's passage. Additionally, 126.84 miles were listed in the "Category One" bracket this year, meaning "potential for abandonment" during the coming year.

Even though the Staggers Act did allow the railroads to apply surcharges for upgrading many of the abandoned lines in Nebraska, these surcharges are not being applied or shippers are not being worked with to find alternative means to increase grain traffic on these branch lines. Some suggested alternatives which the railroads should pursue before abandonment are:

(1). The application of surcharges on grain movement on these lines.

(2) An effort be made to sign a cooperative agreement with shippers by the railroad for a set volume to keep a line viable in the future.

(3) Allow railroads to contract services on these branch lines in the form of smaller engines, outside labor, contracting, and the possibility of a special tax rate.

The abandonment of these branch lines reduces the competition for purchase of grain. By forcing these elevators to go to truck-only transportation means farmers could receive 4-5 cents a bushel less and our road system would receive increased wear-and-tear which a governmental body (state or county) must also absorb in higher expenses.

6. Give railroads immunity from antitrust laws in talking on all grain rail rate

Presently under the Staggers Rail Act, railroads do not have antitrust immunity in making rail rates, unless joint rates and joint routes are being discussed. This should be changed so shippers and the rate bureaus once again could apply common sense and actual cost and revenues in setting or working on these rates.

Set a national system for all leased railroad cars

Presently the shipper is at the mercy of a raiload in signing an OT-5 agreement allowing him to use his own equipment in moving his grain. Some years back railroads were telling grain shippers they must lease their own railroad hopper cars in order to move their grain. Today these cars are being denied OT-5 agreements or being indirectly forced into car leasing pools (contracts). A national system should be set for compensation in a fair and equitable way for both railroad and shipper owned/leased railroad cars.

1980 STAGGER'S RAILROAD DEREGULATION ACT NEEDS CHANGES

As I have outlined earlier, the intentions behind the passage of the Staggers Act to make railroads profitable was very much favored by our Association. However, the passage of the Act and the implementation of the Act has brought unfairness to the grain trade which is unique due to the grain marketing system and the fact most grain shippers are captive to only one railroad. I hope the points I have outlined earlier stressing both the problems and the corrective solutions can be taken by Congress to improve this Act. These changes are urgently needed, so our grain marketing system is not completely disrupted and fragmented sometime in the near future.

On behalf of the Nebraska Grain and Feed Dealers Association and its members, the Association's Board of Directors and Transportation Committee, and Nebraska farmers, I very strongly urge this Subcommittee to take a very close look at some of the positive solutions and alternatives we suggest to the problems caused by the passage of the Staggers Railroad Deregulation Act of 1980. I pledge the support of our Association and it's members in anyway to work with this Subcommittee, the railroads, Interstate Commerce Commission, or any other body to affect these needed changes to problems caused by this Act.

I thank you again for this opportunity to address this subcommittee and I look forward to working with you.

Senator DANFORTH. Thank you, sir.

Mr. Evans.

Mr. EVANS. Mr. Chairman, members of the committee, I am Ted Evans. I am director of traffic and transportation for USS Agri-Chemicals in Atlanta, Ga.

Senator DANFORTH. Could you speak a little more directly into your microphone?

Mr. EVANS. I am appearing on behalf of the Fertilizer Institute and the Florida Phosphate Council. We have filed additional testimony that indicates the perceived revenue inadequacies of the railroads was not true.

In the Staggers Rail Act of 1980, Congress was led to believe railroad earnings were insufficient to generate funds for necessary capital improvements and that by 1985 there would be a capital shortfall of between $16 billion and $20 billion. This finding was adopted from a report submitted by Secretary Brock Adams of the Department of Transportation. The report was entitled "A Prospectus for Change in the Railroad Freight Industry" and was required by section 504 of the Railroad Revitalization and Regulatory Reform Act of 1976.

Over 7 years of the projected 10-year forecast have passed, and there is no evidence that there is or ever was a railroad industry capital shortfall. The railroads had forecast a requirement of 374,000 freight cars in the 10-year period. The AAR records indicate that only 22,000 cars will be acquired.

Appendix A of the Secretary's report shows that the railroads actually forecast a $600 million surplus for the 10-year period, but that forecast was rejected by the DOT based on other analysis which was never referenced or supported. The consultant who prepared those other analyses now advises that a rerun of the computer model used to develop the capital shortfall on actual data since the report was filed would show that there is no capital shortfall.

Recalculation for a 5-year period from 1976 to 1981 develops a capital surplus of $2.519 billion for southern territory carriers, rather than the shortfall of $1.289 billion in the Secretary's report.

We agree with the purpose of the Staggers Act of 1980 to free the railroad industry from regulation where the forces of competition are in operation and at the same time to protect the captive rail traffic from the exercise of monopoly powers by the railroads.

We were led to believe that the Staggers Act intended a balance of fairness between the interest of the railroad and the shippers, and that the Interstate Commerce Commission would interpret and apply the statute so as to give whole recognition to this necessary balance.

We agreed that there is no need for economic regulation when competition exists. However, when competition is not existent, we can not depend solely upon the railroads to be fair. Under the Staggers Act, the Interstate Commerce Commission was mandated to basically do two things to protect captive traffic from unreasonable rates.

These were: Define situations where railroads exercise market dominance and, two, determine the maximum rate railroads can charge traffic subject to that market dominance. However, carrying this mandate has become an endless process in the Commission.

The fertilizer industry has been frustrated by the constant litigation surrounding defining market dominance and establishing a maximum reasonable rate for that traffic. In this regard, virtually every determination of the ICC concerning rail rates has had to be challenged in an effort to achieve some equality for the shippers and receivers of fertilizers.

One example of this has been the Commission's definition of market dominance. The issue has been debated for 6 years now, and we still do not have a definition. The ICC's most recent effort to include product and geographic competition to be considered in determining market dominance is just another indication that the

Commission is unaware that there is such a thing as a captive shipper.

Another example has been the Commission's unrealistic definition of revenue adequacy, which has become the sole criteria for determining if rates are fair. Presently, by the ICC's definition there are no revenue-inadequate railroads. The net result of this determination is that no railroad can be considered revenue-adequate and thereby no rate can be found unreasonable.

It is absurd that the Commission continues to emphasize like a broken record that railroads are revenue inadequate while the railroad actions dictate otherwise. The recent acquisition of the El Paso Gas Co. by the Burlington Northern Railroad and the recent effort of the CSX Corp. to acquire Texas gas resources is evidence to the blind zeal with which the ICC goes about its single purpose. That is to increase the railroad revenues.

Still another example is the Commission's determination to exempt whole areas of service such as boxcar traffic and broad classes of commodities such as export coal. Unquestionably, the Commission shall continue to use this self-perceived exemption power to place all captive shippers such as phosphate, soda ash, and fertilizers beyond rate regulation.

A further example has been the ICC's decision in coal rate guidelines. There it has determined that the maximum rate that can ever be charged a captive shipper is one that is based on the cost of a shipper building his own competitive railroad and supplying the transportation for himself.

Further, the Commission has indicated that it would allow a 15 percent a year increase until the railroad in question becomes revenue adequate. However, as previously stated, with the ICC's definition of revenue adequacy it is almost impossible for them to become revenue adequate. Therefore, the Commission has basically allowed the railroads to take a 15 percent increase per year with no upper limit.

If this were not enough, even though the Staggers Act requires effective competition among rail carriers and other modes, the ICC has permitted railroad mergers, mass elimination of joint routings, gateways, reciprocal switching. Stated simply, all of these actions eliminate competition and foster monopoly.

Congress must address the problems that captive shippers face in rail transportation today. We cannot continue to litigate every decision of the Commission. However, at the present time we have no choice if we wish to protect our industry from the monopolistic price freedoms of the railroad.

In order to maintain a viable rail transportation system which will not stifle economic growth, guidance must be provided that will require routes to apply via all gateways between carriers with physical connections, except when impractical because of security, rates to be reasonable to first interchange when one or more serve a facility unless there are physical track restrictions, railroads to perform reciprocal switching with one or more serve a facility unless there are physical track restrictions.

Competition must not be eliminated because of mergers. We do not suggest reregulation. We do feel, however, that fairness to shippers and competition between and among the modes must be achieved. Otherwise, business will be destroyed and our national transportation capabilities will be severely diminished.

Perhaps in view of the ICC's complete failure to recognize the substantial interest of the shipping community, that agency should be abolished and the remaining necessary regulation transferred to a new organization such as the proposed National Transportation Commission.

Senator DANFORTH. Mr. Evans, I am going to have to cut you off. I am sorry. You have gone over your time.

[The statements follow:]

STATEMENT OF TED EVANS, MANAGER OF TRANSPORTATION, USS AGRI-CHEMICALS

Mr. Chairman, my name is Ted Evans, and I am Manager of Transportation for USS Agri-Chemicals, headquartered in Atlanta, Georgia. I appear here today (July 27, 1983) on behalf of The Fertilizer Institute,[1] as I currently serve as vice chairman of the Institute's Transportation Committee. We appreciate this opportunity to present our industry's views regarding the Staggers Rail Act of 1980 (Public Law 96-448).

The Fertilizer Institute agrees with the purpose of the Staggers Rail Act of 1980 to free the railroad industry from regulation where the forces of competition are in operation and, at the same time, to protect captive rail traffic from the exercise of monopoly power by the railroads.

We were led to believe that the Staggers Act intended a balance of fairness between the interests of the railroads and the shippers and that the Interstate Commerce Commission would interpret and apply the statute so as to give whole recognition to this necessary balance. TFI agrees that there is no need for economic regulation when competition exists. However, when competition is nonexistent, we cannot depend solely on the railroads to be fair.

Under the Staggers Act, the Interstate Commerce Commission was mandated to basically do two things to protect captive traffic from unreasonable rates. These were: (1) Define situations where railroads exercise market dominance, and (2) Determine the maximum rate railroads can charge traffic subject to that market dominance. However, carrying out this mandate has become an endless process at the Commission. The fertilizer industry has been frustrated by the constant litigation surrounding defining market dominance and establishing a maximum reasonable rate for that traffic. In this regard, virtually every determination of the ICC concerning rail rates has had to be challenged in an effort to achieve some equality for the shippers and receivers of fertilizers.

One example of this has been the Commission's definition of market dominance. This issue has been debated for six years now and we still do not have a definition. The ICC's most recent effort to include product and geographic competition to be considered in determining market dominance, is just another indication that the Commission is unaware that there is such a thing as a captive shipper.

Another example has been the Commission's unrealistic definition of revenue adequacy which has become the sole criterian for determining if rates are fair. Presently by the ICC's definition there are no revenue adequate railroads.

The net result of this determination is that no railroad can be considered revenue adequate and thereby no rate can be found to be unreasonable. It is absurd that the Commission continues to emphasize, like a broken record, that railroads are revenue inadequate while their railroad actions dictate otherwise. The recent acquisition of the El Paso Gas Company by the Burlington Railroad and the recent effort of the CSX Corporation to acquire Texas Gas Resources Corporation, is evidence to the blind zeal by which the ICC goes about its single purpose, that is to increase rail revenues regardless of the circumstances involved.

Still another example is the Commission's determination to exempt whole areas of service (such as boxcar traffic) and broad classes of commodities (such as export coal). Unquestionably, the Commission shall continue to use this self perceived exemption power to place all captive shipments such as phosphate, soda ash and fertilizers beyond rate regulation.

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[1] The Fertilizer Institute (TFI) is a voluntary, non-profit association whose members represent approximately 95 percent of the domestic fertilizer production in the United States. The Institute represents over 320 members including producers, manufacturers, traders, retail dealers and distributors of fertilizer and fertilizer materials. Its members are major shippers, receivers and exporters of fertilizer and fertilizer materials, and a vital link in America's agricultural food chain.

A further example has been the ICC's decision in coal rate guidelines. There it has determined that the maximum rate that can ever be charged a captive shipper is one that is based on the cost of the shipper building his own competitive railroad and supplying the transportation for himself. Further, the Commission has indicated that it would allow 15 percent a year rate increase until the railroad in question becomes revenue adequate. However, as previously stated through the ICC's definition of revenue adequacy, it's almost impossible to become revenue adequate, therefore, the Commission has basically allowed the railroads to take a 15 percent a year increase with no upper limit.

If this were not enough, even though the Staggers Act requires effective competition among rail carriers and other modes, the ICC has permitted railroad mergers, mass elimination of joint routings, gateways, and reciprocal switching. Stated simply, all of these actions eliminate competition and foster monopoly.

Congress must address the problems that captive shippers face in rail transportation today. TFI cannot continue to litigate every decision of the Commission; however, at the present time we have no choice if we wish to protect our industry from the monopolistic price freedoms of the railroads.

In order to maintain a viable rail transportation system which will not stifle economic growth, guidance must be provided that will require:

(1) Routes to apply via all gateways between carriers with physical connections (except when impractical because of circuity).

(2) Rates to be reasonable to first interchange when one or more serve a facility, unless there are physcial track restrictions.

(3) Railroads to perform reciprocal switching when one or more serve a facility, unless there are physical track restrictions.

(4) Competition not to be eliminated because of mergers.

We do not suggest reregulation. We do feel, however, that fairness to shippers and competition between and among modes must be achieved. Otherwise, business will be destroyed and our national transportation capabilities will be severely diminished.

Perhaps, in view of the ICC's complete failure to recognize the substantial interests of the shipping community, that agency should be abolished and the remaining necessary regulation transferred to a new organization such as the proposed National Transportation Commission. In this manner, a new start, without the prejudices and predilections of the past, can be made in which the balance between railroads and shippers intended by the Congress can be achieved.

Thank you.

STATEMENT OF FLORIDA PHOSPHATE COUNCIL

INTRODUCTION

My name is Ted D. Evans and I am Director, Traffic and Transportation for USS Agri-Chemicals, a division of United States Steel Corporation. I appear before this Subcommittee today on behalf of the Florida Phosphate Council, Inc. (Council). I wish to thank the Subcommittee for this opportunity to present testimony on the Staggers Rail Act of 1980 (Staggers Act).

The Council is a trade association of fifteen companies, whose names appear on this letterhead, engaged in the mining and processing of phosphate. Phosphate is an essential ingredient in fertilizer. From mines in Florida comes to 80 percent of the U.S. supply of, and one third of the world's demand for, this irreplaceable component in our food chain. The tonnage involved last year—a period of severe depression—was almost 50 million tons, the second largest regional movement of bulk cargo in the country.

As this Subcommittee well knows, the Staggers Rail Act of 1980 was a product of compromise between captive shippers and rail carriers. The intent of Congress, consistent with the 3R Act and the 4R Act amendments to the Interstate Commerce Act, was to foster the development of an economically sound rail transportation system. At the same time, the Staggers Act was to provide sufficient protection for the captive rail shipper. For the vast majority of my company's movements and the movements of members of the Council, we have no alternative but to ship by rail and we have only one railroad to use. Florida's phosphate shippers are therefore captive shippers.

STANDARDS FOR RAIL RATES

Despite the intent of Congress to provide the captive shipper with protection under the Staggers Rail Act, the actual implementation of the Act by the Commission has resulted in great harm to captive shippers by preventing them from effectively challenging freight rates and by decreasing their service options. *See,* Docket No. 37857 *et al., Consumers Power Co. et al. v. Norfolk & Western Railway Co.,* Order served July 1, 1983, wherein Commission Administrative Law Judge (ALJ) Hopkins noted that the Commission's current interpretation of the Staggers Act "will end the usefulness of this Commission to the body of rail shippers." Subsequent to the passage of the Staggers Rail Act, over 800 base rate complaints were filed by shippers, including over 50 complaints by captive phosphate and fertilizer shippers. These complaints were brought pursuant to Section 229 of the Staggers Act which allowed shippers to challenge the base rate in effect as of the effective date of the Act (October 1, 1980).

This provision was intended to provide shippers with some relief to offset the automatic quarterly rate increased under the cost recovery procedures and the 6 percent annual rate increases under the zone of reasonableness. However, because the Interstate Commerce Commission has failed to provide any standards for determining the reasonableness of rail rates, very few shippers have won base rate complaints subsequent to the passage of the Staggers Rail Act and even in those few cases where lower base rates were prescribed by ALJs, on appeal the rate prescriptions were overturned by the Commission. See. e.g., *The Aluminum Association, Inc., et al.* v. *Akron, Canton & Youngstown Rail Co., et al.,* Docket No. 37466, Order served June 8, 1983, wherein the Commission overturned a rate prescription of 190 percent on the basis that the rail carriers were not market dominant, although 95 percent of the commodity involved moved by rail. Thus, of the over 800 cases brought by captive shippers, few, if any served to provide any relief for captive shippers. In the majority of these cases, including cases brought by Council members, although the carriers were found to be market dominant and the revenue to variable cost ratios frequently exceeded 190 percent, sometimes by wide margins, the Commission found the rate involved to be reasonable. *See Martin Marietta Aluminum, Inc. and Kaiser Aluminum & Chemical Corp.* v. *The Atchison, Topeka & Santa Fe Railroad, et al.,* Docket Nos. 37597, 37598, Order served June 14, 1982; *Anaconda Aluminum Company* v. *Burlington Northern, Inc.,* Docket No. 37550, Order served June 19, 1981; *W. R. Grace & Company* v. *Seaboard Coast Line Railroad,* Docket 38059, Order served February 23, 1983. If the Commission had followed Congress' intent, surely some of these 800 cases would have been won by the shippers. To the best of our knowledge, not a single case has been won by a shipper.

Presently before the Commission is a proposal to set rate reasonableness standards for captive coal shipments. Ex Parte No. 347 (Sub. No. 1), *Coal Rate Guidelines-Nationwide,* Order served February 24, 1982. Under the Coal Rate Guidelines, the cap on the reasonableness of the carrier's rates would be the cost of providing service to the individual shipper as if that shipper was the only shipper on the line. In most cases, such stand-alone costing would allow carriers to raise rates to astronomical levels. Indeed, as Attachment A, which was prepared by the Commission, demonstrates, in instances of high mileage or low volume the carriers would be able to recover up to 10 and 15 times their cost of service. Furthermore, under the Commission's proposal, if a carrier is found to be revenue inadequate, it is entitled to 15 percent annual rate increases above the rate of inflation. Such increases apparently would be permitted despite Section 203(a) of the Staggers Rail Act, 49 U.S.C. § 10707a, which expressly provides carriers with a 6 percent zone of reasonableness—not 15 percent.

Although the Coal Rate Guidelines, by their very name, were not to be applicable to phosphate shippers, there has been much concern by captive shippers that in lieu of developing standards of reasonableness for non-coal shippers, the Commission will impose these guidelines on all captive movements. Indeed, in several recent Commission decisions, the Commission has indicated its intent to apply these Guidelines to non-coal commodities. Thus, the concerns about these guidelines discussed above are shared by all shippers, including members of the Council.

The Ford Bill, S. 1082 and the Rahall Bill, H.R. 2584, would limit the Commission's discretion in this area by setting standards for rail rates so as to give captive shippers more protection through Commission rate regulation. Section 1 of these bills require the Commission to maintain reasonable rates where there is an absence of effective competition. Under the present statute, greater emphasis is given to aiding rail carriers in becoming revenue adequate, than in maintaining reasonable rates for captive shippers.

Section 2 of the bills require the Commission to take into consideration factors such as the relationship between the revenue that the carrier derives from providing service and the cost of service. As noted earlier, in many recent Commission cases, although the carrier has been found to be market dominant and it has been demonstrated that the carrier is recovering two and three times the cost of service, the Commission has found the rate to be reasonable. See *Martin Marietta Aluminum, Inc. and Kaiser Aluminum & Chemical Corp.* v. *The Atchison, Topeka and Santa Fe Railrad, et al.*, Docket Nos. 37597, 37598, Order served June 14, 1982. Section 2 of these bills also clearly imposes the burden of proof on the carrier to establish the reasonableness of a rate where the rate in question exceeds 190 percent of variable cost. Many shippers have taken the position that the Staggers Act imposes the burden of proof on carriers where the rate exceeds 190 percent, but the Commission has frequently interpreted this language as applying only to new rates. See *Aluminum Company of America* v. *Burlington Northern, Inc.*, Docket No. 37699, Order served September 21, 1982. The bills would serve to finally resolve these problems. We strongly support these bill's passage.

REVENUE ADEQUACY

Subsequent to the passage of the Staggers Rail Act of 1980, the Commission reviewed its procedures for evaluating the revenue adequacy of rail carriers and adopted as its sole standard, the carrier's net return on investment based upon the current cost of the capital. Ex Parte No. 393, *Standards for Rail Revenue Adequacy*, Order served March 30, 1981. Under the revised standard for revenue adequacy, there is not a single Class I railroad in the United States today which is revenue adequate. Ex Parte No. 439, *Revenue Adequacy—1981 Determination*, Order served November 18, 1982. As a result of the Commission's new interpretation of the meaning of revenue adequacy and the greater emphasis given to revenue adequacy in the transportation policy section of the Staggers Rail Act, there have been few, if any, prescriptions of maximum rates subsequent to the Staggers Act. Rather, the Commission has been relying more and more heavily upon the argument that since the carrier is revenue inadequate, it is entitled to raises rates as high as necessary to enable it to become revenue adequate. A now classic example of this reasoning is found in the *Martin Marietta Aluminum, Inc.* case mentioned above, wherein ALJ Earl Dowell noted that even a rate which returned five times the carrier's cost of service was not unreasonable, in light of the need of that carrier to achieve revenue adequacy. Similar reasoning has been applied to cases involving phosphate shippers. See *Agrico Chemical Co.* v. *ICC*, 361 I.C.C. 33 (1979), aff'd 652 F.2d 195 (D.C. Cir. 1981).

The Ford and Rahall bills would solve this problem by requiring the Commission to take into consideration a variety of widely used indicators of financial health in addition to the return on investment, to determine revenue adequacy. Furthermore, Section 3 of the bills would further define the manner in which the Commission calculates the return on investment so that it would not be relying solely upon the current cost of capital. We think this is a resonable interpretation of what Congress really intended when it enacted the Staggers Act. Accordingly, we urge the Subcommittee to consider S. 1082 and H.R. 2584, which would curb the Commission's discretion in this area. We believe that under Sectgion 3 of S. 1082 and H.R. 2584 the Commission's revenue adequacy determinations would more closely conform to real world or businessmen's views of the financial health of the rail carriers.

RAIL COST ADJUSTMENT FACTOR

Under the Staggers Rail Act, carriers are entitled to take automatic quarterly increases to offset the rate of infaltion. Under Commission procedures developed in Ex Parte No. 290 (Sub No. 2), *Cost Recovery Procedures.* Order served June 1, 1981, the Commission adopted the AAR index as a measure of the effect of infaltion on costs of the railroad industry. However, many shippers argued that the AAR index failed to consider the benefits of railroad productivity which served to reduce railroad costs. Although this matter was much litigated and the Commission finally initiated a proceeding to consider productivity (Ex Parte No. 290 (Sub No. 4), *Rail Productivity Adjustment Factor,* Order served July 23, 1983), it has never issued a final decision on this subject. As a result, shippers are forced to pay additional freight charges based upon the automatic quarterly increases, even though these increases may not really reflect some of the productivity gains made by the railroads.

Section 4 of the Ford and Rahall bills would require the Commission to consider changes in railroad producitivty in calculating the index used for the automatically quarterly increases. Because of the importance of this provision to rates for captive shippers we strongly support this Section of these bills.

MARKET DOMINANCE

Although the Staggers Rail Act did not amend the provisions of the Interstate Commerce Act relating to determinations of market dominance, the Commission, on its own initiative, elected to institute a new rulemaking repealing the previous market dominance regulations and setting forth new market dominance guidelines. The new guidelines were promulgated in Ex Parte No. 320 (Sub No. 2), *Market Dominance Determinations and Consideration of Geographic and Product Competition* and allowed the introduction of evidence of geographic and product competition. The new guidelines also eliminated presumptions of market dominance based upon the railroad's market share of the traffic and based upon the shipper's investment in rail facilities. As a result, many shippers dismissed their base rate complaints because they were unable to show that the carrier was market dominant under the new guidelines. In addition, on occasion, the Commission has dismissed cases on the basis that the carrier is not market dominant. See *Aluminum Company of America* v. *Burlington Northern, Inc. et al.*, Docket No. 37715, Order served April 11, 1983.

A number of shippers challenged the Commission's "guidelines" in the United States Court of Appeals for the Fifth Circuit. By decision released in December of 1982, the Fifth Circuit struck down the consideration of product competition and geographic competition. *Western Coal Traffic League* v. *ICC*, 694 F. 2d 378 (5th Cir. 1982). However, this case is presently before the Fifth Circuit for rehearing en banc. Section 5 of the Ford and Rahall bills would codify the market share and substantial investment presumptions which were contained in the Commission's original market dominance regulations and would prohibit consideration of product competition and geographic competition. We strongly support this provision.

EXEMPTIONS

The Staggers Rail Act also amended the provisions relating to the Commission's power to exempt rail traffic. Under revised 49 U.S.C. § 10505, the Commission may exempt a portion of traffic from regulation if it finds that continued regulation is not necessary to carry out the national rail transportation policy and that either the service involved is of limited scope or regulation is not needed to protect shippers from an abuse of market power. Despite these express limitations on the exemption power, the Commission has proceeded to exempt all rail boxcar traffic, which accounts for approximately 40% of all rail traffic, and thus certainly cannot be considered limited in scope, and all export coal traffic, which is primarily captive traffic. Ex Parte No. 346 (Sub No. 8), *Exemption From Regulation—Boxcar Traffic,* Order served May 2, 1983; Ex Parte No. 346 (Sub No. 7), *Railroad Exemption—Export Coal,* Order served June 8, 1983.

Section 5(b) of the Ford and Rahall bills would prohibit the Commission from exempting market dominant traffic (unless such traffic was pursuant to contract). Because of the dangerous precedent set in the boxcar and export coal cases, we believe that such an express statutory prohibition is necessary to protect phosphate shippers from further Commission action.

RAILROAD ACCOUNTING PRINCIPLES BOARD

Section 302 of the Staggers Act provided for a Railroad Accounting Principles Board which was to set forth uniform principles relating to the costing of rail movements. The purpose of the Board was to alleviate the extensive arguments regarding cost data submitted by carriers and shippers in rate reasonableness proceedings. However, despite the express statutory mandate to establish such a Board, no funds were ever appropriated for the Board and no members were ever appointed.

Section 6 of the Ford and Rahall bills would require the Controller General to appoint members to the Rail Accounting Principles Board within 120 days of enactment of this bill. The Florida Phosphate Council strongly supports the formation of this Board.

DEFLATION AND REDUCTION OF RATES

Under the procedures developed in Ex Parte 290 (Sub No. 2), the carriers are permitted automatic quarterly increases based upon the increase in the rate of inflation. However, the statute is silent on the issue of rate decreases when there is a reduction in the rate of inflation from the previously published rail cost index.

Thus, when the railroad costs decreased in the second quarter of 1982, railroads did not reduce their rates automatically, but instead simply did not take an increase. Despite shipper requests that the Commission require the railroads to reduce rates, the Commission concluded it was unnecessary to require a reduction. *Petition for Declaratory Order—National Industrial Traffic League,* Ex Parte No. 290 (Sub No. 2), Order served April 12, 1982.

S. 1081, a companion to Ford's bill S. 1082, would require the railroads to decrease their rates when there is a concomitant reduction in costs. The Council strongly supports this bill and urges this Subcommittee to take action on this proposal.

JOINT RATES, JOINT ROUTES

Section 217 of the Staggers Rail Act permitted carriers to cancel out participation in joint rates and to impose surcharges on existing joint rates. 49 U.S.C. § 10705a. As a result, subsequent to the passage of the Staggers Rail Act, joint rate/joint route service has decreased markedly. See *Family Lines Rail System—Unilateral Cancellation of Joint Rates,* 365 I.C.C. 464 (1981), aff'd *Southern Railway* v. *I.C.C.* 681 F. 2d 29 (D.C. Cir. 1981). The reduction in joint rates has made it more difficult for shippers to move their goods from location A to location B where the only routing between the two points is over two connecting railroad lines. Thus, while railroads are common carriers, Section 217 of the Staggers Rail Act has enabled them to curtail service or to impose a surcharge on service which is not profitable to them. Shippers may no longer rely on a nationwide system of railroads which permits them to ship their goods on a number of lines at a fixed rate. Rather, shippers are being forced to rely upon larger railroads for entire shipments, even though such routings are longer than a similar joint route movement.

The Commission still has discretionary authority to require through routes and prescribe joint rates (49 U.S.C. §§ 10703, 10705). However, 49 U.S.C. § 10705a permits unilateral application of a surcharge where a carrier's share of the revenue is below 110 percent of variable costs. Thus the interaction of these sections clearly gives carriers greater opportunities to cancel through routes than previously existed. This, plus the Commission's apparent bias in favor of railroad management decisions makes it very unlikely that the Commission will ever seek to exercise its power to require joint rates and through routes.

In light of the Commission's interpretation of the Staggers Act as relates to joint rates, the Council urges the Congress to enact legislation which would require railroads to participate in joint rates and joint routes, so as to ensure an adequate national transportation system.

INTRASTATE RATES

Section 214 of the Staggers Rail Act permits the state Public Service Commissions to exercise jurisdiction over intrastate rail transportation only if the state acts in accordance with the provisions of the Interstate Commerce Act as amended by the Staggers Act. 49 U.S.C. § 11501(b)(1). To assure this result the statute provides that the state commissions cannot regulate intrastate movements until the Commission certifies that the state's standards and procedures applicable to such regulation are in accordance with the standards and procedures applicable to the regulation of interstate movements. In Ex Parte No. 388, *State Intrastate Rail Authority,* Public Law No. 96-448, the Commission has been reviewing the standards and procedures submitted by the state commissions and has thus far provisionally certified all states which have desired to continue to regulate intrastate rail transportation. These states are therefore currently allowed to exercise jurisdiction pending final certification.

The statute also provides that a rail carrier may petition the Commission to review the decision of any state authority on the grounds that the standards and procedures applied by the state are not in accordance with the provisions of the Interstate Commerce Act, as amended by the Staggers Act 49 U.S.C. § 11501(c). Although the clear intent of this section was to have the Commission act as a monitor to determine simply whether the state applied standards and procedures consistent with the Staggers Rail Act, the actual result of this section has been that the Commission has grossly exceeded its statutory review authority by making a *de novo* review of these state decisions, substituting its own judgment for that of the state commissions, and prescribing higher rates. See Docket No. 38793, Petition for Review of a Decision of the Public Service Commission of West Virginia Pursuant to 49 U.S.C. § 11501, Order served March 18, 1982. Although this decision is on appeal to the United States Court of Appeals for the Third Circuit, in the interim, the shippers must pay the higher rates prescribed by the Commission.

Similarly, in the Ex Parte No. 388 certification proceedings, the Commission has also sought to deprive the state commissions of any independent authority to regulate rates. For example, in the State of Florida, where the majority of our members have intrastate movements, although the Florida Public Service Commission adopted standards and procedures consistent with the Staggers Rail Act, the Commission required a clarification that the Florida PSC would adopt all the exemptions adopted by the Interstate Commerce Commission. Ex Parte No. 388 (Sub No. 4), *State Intrastate Rail Rate Authority—Florida,* Order served March 18, 1983. Such action by the Commission goes far beyond its statutory authority to require that the standards and procedures of the state commission are in accordance with federal standards and procedures. 49 U.S.C. § 11501(b)(3)(A). Although the Florida Public Service Commission has challenged the Commission's action in the United States Court of Appeals for the Eleventh Circuit, the Commission continues to run roughshod over other state commission procedures with impunity.

The effect of the Commission exceeding its statutory authority and abusing its discretion in this manner has been to deprive shippers of a remedy from excessively high rail rates at both the federal and state level. Traditionally, shippers have challenged intrastate rates before state commissions where they were able to obtain a fair and prompt hearing. However, subsequent to the Staggers Rail Act, shippers have lost the opportunity for a fair and prompt hearing before a state commission. In effect, a hearing before the state commission is no different than having a hearing before a regional office of the Interstate Commerce Commission.

The issue of the Commission's interpretation of Section 214 of the Staggers Act is another example of how the Commission has exceeded the authority and discretion granted to it under the Staggers Act and thus harmed captive shippers. Effectively, due to the Commission's interpretation of the Staggers Act, shippers have no remedy from excessively high rail rates, at the federal or the state level. The Council believes that this is another issue which should be considered for remedial legislation to provide captive shippers with some protection against monopoly pricing on intrastate rates.

CONCLUSION

The Council believes that the Staggers Rail Act is a workable act. However, the Commission's interpretation of the Act has resulted in many problems as noted above. The Council believes that the proposed Rahall and Ford amendments to the Act would serve to properly limit the Commission from exercising too much discretion in interpreting the Staggers Rail Act and thus resolve some of these problems. Accordingly, the Council respectfully urges the Committee to give serious and prompt consideration to these bills.

INTERSTATE COMMERCE COMMISSION MEMORANDUM, DECEMBER 21, 1982

To: Commissioners' Staff Members.

From: Ronald S. Young, Director, Bureau of Accounts.

During the staff briefing held October 22, 1982 on Ex Parte No. 347 (Sub. No. 1), Maximum Coal Rate Guidelines—Nationwide, a number of individuals requested data on the range of revenue-variable cost ratios which could result from our proposed formulation of stand-alone costs. Attached are hypothetical stand-alone costs for Union Pacific and Louisville and Nashville data. Across the top of the matrix are various annual volumes for stand-alone shipper(s); down the left side are various mileage blocks. The costs for each element of the matrix were developed using the methodology described in the draft decision for the prima facie showing only. That is, the major track accounts are restated on a depreciated current cost basis and assigned totally to the stand-alone volume; but no adjustments for optimal plant size were made, as would occur in an actual case before the Commission. The consequence of this limitation is that the revenue-cost percentages for the extreme volumes are biased. For these annual volumes, our prima facie data of "plant in place" overstates or understates what is necessary to provide service efficiently (minimum long-run average cost) and the revenue-cost percentages are substantially above what would result if the appropriate adjustments for plant size were made.

For example, the Union Pacific costs were based on double mainline track. Thus, actual stand-alone cost for low volume movements may be less than what is shown for the prima facie case. However, without specific facts, we were reluctant to make any adjustments. Rather than speculate on the types of cost adjustments which could be made, we identified what we believe is the "relevant range" of volumes and movements at the prima facie investment level. We believe these volumes and distances would utilize approximately the same quantity of investment which is in place. The "relevant range" for each carrier is identified by the marked area.

The "relevant range"for the two illustrated carriers differ because of variances in the plant size and operating characteristics. The Louisville & Nashville is primarily a single mainline road, with relatively short hauls (not exceeding approximately 800 miles). Thus, its "relevant range" reflects the smaller capacity and shorter haul. As noted, the Union Pacific is primarily double line and has hauls approaching 1500 miles. Accordingly, we have moved the "relevant range" toward the higher densities and longer hauls.

I stress once again that the data shown is hypothetical and that the "relevant range" is based on our judgement.

Because stand-alone cost calculations are fairly complex, I will have a briefing on how the costs for the Union Pacific and Louisville and Nashville Railroads were derived. My secretary will contact you to set up a briefing date for next week.

If you have any questions, please call me.

Attachments.

STAND-ALONE COSTING SIMULATION FOR A TYPICAL UNION PACIFIC TRAINLOAD MOVEMENT AT VARIOUS MILEAGES AND LINE SEGMENT TRAFFIC DENSITIES

[Ratio of stand-alone rate to variable cost, in percent]

Miles/annual volume (tons)	500K	1,000K	5,000K	10,000K	20,000K	50,000K	70,000K	90,000K
50	1,119	640	256	208	185	170	168	166
100	1,396	777	282	220	190	171	168	165
150	1,527	843	295	227	193	172	168	166
200	1,603	881	302	230	194	172	168	165
300	1,689	923	310	233	195	172	168	165
500	1,762	959	317	236	196	172	168	165
750	1,806	981	321	239	197	172	168	165
1,000	1,827	992	323	239	198	172	168	165
1,250	1,841	998	324	240	198	172	158	165
1,500	1,850	1,003	326	241	198	172	168	165

STAND-ALONE COSTING SIMULATION FOR A TYPICAL LOUISVILLE & NASHVILLE TRAINLOAD MOVEMENT AT VARIOUS MILEAGES AND LINE SEGMENT TRAFFIC DENSITIES

[Ratio of stand-alone rate to variable cost, in percent]

Miles/annual volume (tons)	500K	1,000K	5,000K	10,000K	20,000K	50,000K	70,000K	90,000K
50	766	456	209	178	161	153	151	150
100	903	522	218	179	160	148	147	145
150	969	555	223	181	160	147	146	144
200	1,003	571	225	182	160	147	145	143
300	1,044	591	228	183	160	146	144	142
500	1,078	607	230	183	159	145	143	141
750	1,095	615	231	183	159	145	142	140
1,000	1,105	620	232	183	159	145	142	140
1,250	1,110	622	232	183	159	145	142	140
1,500	1,115	625	233	183	159	145	142	140

SUPPLEMENTAL STATEMENT OF THE FERTILIZER INSTITUTE AND THE FLORIDA PHOSPHATE COUNCIL

Section 504 of the 4–R Act[1] required "the Secretary of Transportation to develop and transmit to Congress a comprehensive study of the Nation's rail system and the *capital needs* of the railroads industry . . ." (emphasis added).[2]

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[1] The Railroad Revitalization and Regulatory Refor[illegible]ct of 1976, 45 MSC 824.

[2] Federal Register, vol. 43, No. 214, Nov. 3, 1978.

Secretary Brock Adams submitted Congress *A Prospectus for Change in the Freight Railroad Industry*[3] that advised, "The Federal Railroad Administration's (FRA) estimate of the railroad industry's sources and uses of funds (excluding the Consolidated Rail Corporation (Conrail) and the Long Island Railroad (LIRR) indicate that unless actions are taken to reverse current trends, the industry faces a potential capital shortfall of between $13.0 billion and $16.2 billion during the period 1976–1985."[4]

The Congress adopted the conclusion in the Secretary's report in its findings in the *Staggers Act.*[5] It found that: *"earnings by the railroad industry* are the lowest of any transport made and *are insufficient to generate funds for necessary capital improvements;*" and *"by 1985, there will be a capital shortfall within the railroad industry of between $16,000,000,000 and $20,000,000,000;*" (emphasis added).

The increase in capital shortfall findings of the Congress from the conclusions in the Secretary's report are assumed as adjustment for inflation.

The question that should be before the Congress today, nearly eight years into the Secretary's ten-year projection of capital shortfall, is whether there is or ever has been a shortfall. This question directly affects the Congressional "Goals" set forth in the Staggers Act that provide, "The purpose of this Act is to provide for the restoration, maintenance, and improvement of the physical facilities and financial stability of the rail system of the United States."[6] And the amendments to "Rail transportation policy that provide, ". . . it is the policy of the United States Government—(3) to promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues, as determined by the Interstate Commerce Commission; . . ."

Without any evidence of a capital shortfall, this Committee of the Congress should pass a resolution directing the ICC to administer the Staggers Act as it was originally mandated; to observe the "Goal,"

"(4) to provide a regulatory process that *balances* the needs of carriers, shippers, and the public; . . . " (emphasis added) and to promote the "Rail transportation policy"

"(2) . . . to require *fair* and expeditious *regulatory decisions* when regulations is required;"

"(4) to ensure . . . a sound rail transportation system with *effective competition among rail carriers* . . . ;" and

"(6) to maintain *reasonable rates* where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital;" (emphasis added)

Our review of the Secretary's report reveals that about 50 percent of the projected shortfall was concentrated in marginal or bankrupt companies that together generated only about 20 percent of the rail industry's revenue.[7] Since the report was published most of these companies have ceased operation like the Rock Island, have cut their systems back to a core-railroad like the Milwaukee Road, or have rationalized their rail systems through track abandonments like the Chicago & Northwestern and the Illinois Central Gulf.

Our careful rereading of the Secretary's report[8] develops that the Department of Transportation (DOT) requested forecasts from each Class I railroad (excluding Conrail). The forecast of the industry was based on the current and projected financial capabilities of the railroads, including the raising of funds through normal commercial channels but excluding any Federal funding. An aggregation of the industry forecast shows "that projections of the railroad industry's sources and uses of funds (excluding Conrail and Amtrak) would essentially balance. Total sources of funds for the 1976–85 period were estimated to be $41.8 billion, and total uses were projected to be $41.2 billion." After reviewing and comparing the results of the railroad industry's forecast to *"other analyses"* (emphasis added), the FRA concluded that, "the projected sources and uses of funds derived from the industry submissions (Table A-1) were *unrealistic*" (emphasis added). The report does not explain or reference the "other analyses" used to create its alleged capital shortfall. The report admits to "flaws in the initial instructions" to the railroads and presents unsubstantiated reasons why the FRA rejected the industry forecast. As an example, the FRA reported that the industry had implied an "acquisition of approximately 374,000 freight cars and 10,837 locomotives during the 1976–85 period."[9] However the FRA reasoned that "The projected additions to the equipment fleet, when aggregated, were significantly less than would be expected given the high-growth rates used in the survey."[10] We have compared the industry forecast and the FRA reasoning for greater numbers of freight cars to be required with the number of cars actually acquired in the seven years from 1976 through 1982[11] and a forecast for the years 1983 through 1985 (based on the average of 1981 and 1982) (see Attachment I). This comparison shows that the industry forecast resulting in a $600,000,000 capital funds surplus far exceeds actual expenditures for cars by over 152,000 cars (374,000 less 222,000=152,000 excess). Comparison with the FRA reasoned greater numbers of cars to be required would show a substantially greater disparity. However we were unable to show that magnitude of error because the FRA didn't reveal the number of cars actually used in its report.

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[3] Oct. 10. 1978.

[4] "Prospectus, etc," Chapter 3, page. 65.

[5] The Staggers Rail Act of 1980, section 2 (5) and (6), 49 U.S.C. 10101a.

[6] Section 3, 49 U.S.C. 10101.

[7] "Prospectus, etc.", chap. 3, p. 65.

[8] "Prospectus, etc.", App. A, "Analytical Methods,"

We have learned that the "other analyses" used by FRA to develop its projections of capital shortfall were prepared by Consulting Center Associates, Inc., of Alexandria, VA. They have offered to shippers to redo the calculations of the so-called capital shortfall gap espoused by the DOT using the same computer model used to prepare the Secretary's report. As an example of what that recalculation would show, they have advised that the original forecast for Southern Carriers from 1976 to 1981 projected a shortfall of $1,289,100,000; whereas the relative funding based on actual data develops a surplus of $2,519,200,000 for these carriers.

The rejected railroad forecast of a capital surplus have proven to be correct. The FRA conclusions and analyses of a shortfall have been proven to be in error. No industry-wide capital shortfall exists in the railroad industry (excluding Conrail). The need for revenue adequacy to meet a capital shortfall is an illusion of the "Prospectus" and is built on a house of sand.

From: "The Economic ABZ's of the Railroad Industry," Association of American Railroads, 1982.

TABLE II–11.—FREIGHT CAR INSTALLATIONS DECLINED IN 1981

Year	Railroads	Other railroads and "private" companies	Total
1971			
1972			
1973			
1974			
1975			
1976	31,757		
1977	29,478		
1978	29,067		
1979	31,986		
1980	31,006		
1981	21,063		
Total	174,357		
1982	6,420		
1983[1]	13,742		
1984[1]	13,742		
1985[1]	13,742		
Total	222,003		

[1] Average of actual 1981–82 data.

Senator **Danforth**. Mr. Gordon.

Mr. **Gordon**. My name is David B. Gordon and I am the manager of the Ritzville Warehouse Co. in Ritzville, Wash. I worked for a country elevator for 3 years before moving to Portland, Oreg., as a grain buyer and trader for Northern Pacific Grain Growers.

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[9] Supra, p. 148.

[10] Supra, p. 149.

[11] "The Economic ABZ's of the Railroad Industry," Association of American Railroads, 1982.

I have been ~~manager of~~ the Ritzville Warehouse for 5 years. Ritzville Warehouse is a cooperative owned by 670 members. Ritzville is a country storage operation owning grain elevators at seven different locations. Ritzville Warehouse stores, markets, and transports grain for their members. Our company handles an average of 5 million bushels per year. Of the 47 local cooperatives in the Northwest, we are the 7th largest.

The company operates a unit train facility at Ritzville, Wash. which will handle 26 cars. The warehouse also has single car capabilities at three elevators. The facility at Maier is a truck-barge station. The facilities at Marcellus and Ralston were on the Milwaukee Railroad.

Ralston was on the main line of the Milwaukee and Marcellus was on a branch line. The tracks have been abandoned on these two stations, causing them to become truck only stations. After we lost the Milwaukee Railroad, we shipped 50 percent of our grain by truck-barge to the Columbia River district.

In my 5 years of dealing with the Burlington Northern, the service has never been better since the advent of the unit train. The rate at Ritzville on July 1, 1978, was 37 cents a hundredweight. The unit train rate this July is also 37 cents a hundredweight. Very few items have maintained a constant level for a 5-year period.

If the Staggers Act enabled the Burlington Northern to become more innovative and competitive to attract business, this has been a help to our producers in lowering the cost of transportation to the coast. In the same 5-year period truck freight rates have increased 30 percent in our company.

The Ritzville Warehouse has changed its operation to adjust to the changes in the railroad structure in the following ways. We have converted our outside stations to fast shuttle facilities to move grain to the unit train operations; we have remodeled our unit train facility to handle 26 cars; we have installed an electronic scale to weigh the grain, and remodeled the machinery in Ritzville—all of which cost the company $200,000.

The improvements have made our operation more efficient by concentrating the loading in 1 day. The BN has also improved efficiency. Instead of spotting two or three cars at four of our locations, the train stops once at Ritzville. It is easier for the railroad to monitor a 26-car unit train than 1 or 2 cars at several locations.

We have loaded 86-unit trains since July 1, 1981. This amounts to shipments of over seven million bushels in 2 years. The warehouse saved over $350,000 by shipping unit trains compared to the truck-barge rate to the coast. If we would have loaded single cars, the additional freight would have amounted to $588,000. Our company has been able to lower our freight charge, thus giving the farmer a higher price for his grain.

If the Staggers Act helped BN to get more responsive to people, to make the commitment to service, the act will be beneficial for all. The last 2 years, the BN personnel have met these objectives in our company.

Ritzville Warehouse has also been able to negotiate a contract rate on wheat and barley from Ritzville. We are cleaning and reloading aluminum cars for destinations on the coast. The loading of the cars has helped the railroad utilize the cars for a backhaul. This savings has been passed back to our members.

The contract rate has enabled us to be more competitive for grain this past year. We have put through a larger volume of farm storage grain in our area.

Ritzville Warehouse supports the Staggers Act allowing the railroads to abandon rail service that is not profitable. The days of the railroad servicing every community is not feasible anymore. The railroad can no longer service one customer on a branch line because of the cost of maintaining the track. We have had experience with the Milwaukee Railroad closing trackage because of operating nonprofitable rail lines. We do not want this to happen to the BN.

We do not believe we should pay for the upkeep of these branch lines by having our rates increased to cover the costs of these lines. We have modified our facilities to make our operation in the BN more efficient. We believe we should benefit with reduced rates.

If the Staggers Act provides for a shipper and a rail carrier to continue to move grain at the lowest transportation cost, the Ritzville Warehouse members will benefit from these parts of the Staggers Act.

Thank you.

Senator DANFORTH. Senator Exon.

Senator EXON. Thank you, Mr. Chairman. I wish to apologize to members of the previous panel for not being here. We had a briefing this morning by the Secretary of State and the National Defense Advisor to the President regarding the situation in Central America.

The chairman could not be there because he was at this meeting, and that is some of the price that the majority must pay. They have to be here for the meetings that they schedule. I just want to say to you, John, that you missed nothing and if you read the Washington Post today you will know more than we found out.

Senator DANFORTH. I guessed as much.

Senator EXON. I want to thank the members of this panel for being here.

My questions will be addressed primarily to Bob Anderson, whom I have known for a very long time and worked with over the years on the problem of shipping of the products of Nebraska farmers to market. We have been able to work the problems out before.

I have read through Mr. Anderson's testimony, and Bob, I think the good news is that in your statement you said that with the problems that we have encountered with the Staggers Act, this outcry would have been even larger if the grain trade faced a merchandising of grain versus a storage of grain environment. That is the only good news that I see in your statement, but I think it is critically important, and I thank you all for coming here to make suggestions to us.

Yesterday we had a long, and also a very interesting, hearing that was focused primarily on the movement of coal and the expenses and difficulties that the utility companies were experiencing, not unlike what you have all testified to here this morning.

I remember well the hearing we held that is mentioned in Mr. Anderson's testimony. That was on July 6, 1979, in Omaha, Nebr., when we addressed the very concerns that for the most part you are addressing here again now. We worked very closely together, all of us, with regard to making amendments to the Staggers Act. We all supported the act because we felt basically that we had addressed some of these problems.

Most of that testimony in 1979 was with regard to captive shippers. Let's focus on the captive shipper issue for just a moment.

Do you believe that if we had the proper attitude at the ICC, the captive shipper clauses that we wrote into the bill would suffice, or do you think we must make changes in the law itself?

Mr. ANDERSON. Senator, it was mentioned earlier market dominance for a shipper needs defination. If this could be defined and then small shippers could then litigate or go to court to address some wrong. For instance, if they had all the needed information in a contract, they could address wrong on a equipment or anything else defined in market dominance. If the shipper had the information on what the railroad's costs were, then they could apply it to their line and seek correction to problems.

But, I think it is going to take some additional legislation in the act to put in protections for those small shippers, those captive shippers, because there is nothing keeping a check-and-balance now for these shippers. Or, maybe the idea of allowing another railroad to run on another railroad's line, something of this nature, so then we have free market forces competition. That is what keeps the grain trade going, competition, and that is what keeps the farmer getting the best price for his grain, competition.

Senator EXON. Mr. Anderson, in your testimony you make an excellent point, it seems to me, with regard to the particular problems that we have with the movement of grain and the price that we pay the farmers for grain—that is, that grain delivered to the elevator and the price the farmer receives for that. Basically in the past the elevator operator knew what his handling charges were and he knew what his transportation costs were going to be in the future, and therefore he could obtain the top penny for the bushel of grain or whatever it was.

I noticed in your oral testimony this morning that you said that 30 days was simply not long enough notice on rate changes. That is all the notice that the railroads give you at this time.

Have you arrived at some number of days that you think would be adequate? Is it 60? Is it 6 months? Or is it 360 days?

Mr. ANDERSON. Well, we are talking about 30 days, and that can be changed now when you have an amendment to a contract or you have had some other seasonal change. I suppose what the grain trade needs is a warning system that these rates will change. We also have the index we have to follow. If it goes down, that does not necessarily mean we are going to get our rates reduced, which they have not been. But if we had an idea a rate increase was even coming, even, then that could be factored into a future delivery because what you do is just take the board price, take your known expenses: Handling, transportation, and the difference is essentially, plus your margin, is what you offer the farmer.

Senator EXON. And with that scenario as you just outlined, because of the uncertainty, the elevator operator has by necessity had to raise his spread, and that really comes out of the price that the farmer gets, is that right?

Mr. **Anderson**. Definitely. He is going to have to do that. Otherwise, it is going to have to come out of his own pocket, and those margins are not that big in the grain business.

Senator **Exon**. I have one or two more questions, but my time is up for this round, Mr. Chairman.

Senator **Danforth**. Go ahead.

Senator **Exon**. I have not heard much discussion today with regard to ICC's determination of revenue inadequate railroads.

Have you had some difficulty with that? There was, I believe, Mr. Anderson, in your testimony some reference with regard to rail accounting procedures and what principles are followed.

Could you elaborate on that and share with us whether or not you have the same concern with the way the railroads report their earnings as members of the panels did yesterday?

Mr. **Anderson**. I think our concern under the Staggers Act is there was a board on accounting principles set up, only it has not been implemented. Part of the problem with small shippers, is if we can have this Board they could know how all railroads figure their costs, their expenses, and know what is in a rate. As an example, then that small shipper could take that set information, and when abandons a branch line or when the shipper goes to look for a better rate on grain, then he has a known base of information. Right now, various railroads have various sets of information and costs, and you may or may not get it or be able to apply it.

I think by having that base of information through this Board, it could then be applied by everybody that deals with the railroad as a safeguard and make the railroads as a public carriers.

Senator **Exon**. Mr. Anderson, do you or any other member of the panel care to comment on a basic underlying question—do you believe that the railroads have a continued obligation to serve as public common carriers?

Mr. **Anderson**. I definitely do, and I think that is why we had the Interstate Commerce Act in 1887, and I am sure maybe some of the other panel members have the same ideas, too.

Senator **Exon**. Does anybody else care to comment on that question?

Mr. **Stepner**. I do not think there is any question that as far as the grain trade is concerned, there is such a reliability on rail transportation that railroads need to be considered as common carriers.

If I may, Senator, I would also like to address the issue of notice that you asked about. I think that the grain trade and the members of the National Grain and Feed Association are basically satisfied with the notice procedures in Staggers which calls for 10-days notice on rate reductions, 20-days notice on rate increases, and 30-days notice on contracts. The problem is that the Interstate Commerce Commission has completely disregarded Staggers and recently came out with a decision that any contract filed can go into effect with no notice, not even 1 day's notice, and in some cases contracts have been made on a retroactive basis.

Senator **Exon**. Is that not a violation of the law that the Congress passed?

Mr. **Stepner**. I think it is, personally, and it certainly goes beyond the intent of Congress.

I think that makes the point that you cannot rely on the Interstate Commerce Commission for a fair interpretation of the act. I think it is up to Congress to specifically spell out very strongly what the intent is for the Commission to do.

Senator **Exon**. Any comment on those questions by the other members of the panel?

Mr. **Evans**. Of course, all railroads should maintain a common carrier obligation. Every industry has a social obligation if nothing else. And if they are permitted to restrict their service and serve only the highly profitable areas, the small shipper, the farmer, the rural community will not be served, and the people that are served will not be served impartially.

Senator **Exon**. Mr. Chairman, I just have one more question.

We are referring to the same information which was received yesterday, which is that the major portion of our problem seemingly is the attitude of the ICC. Since we probably cannot depend on the ICC, it would be apparent to me, Mr. Chairman, that we are going to have to make some changes in this law. And this one Senator will be working toward that end, as I am sure will other members of the subcommittee and the Commerce, Science, and Transportation Committee itself.

My last question is whether you believe that railroads should be permitted to merge, and what experience have you had in your trade since the mergers are continuing to take place?

Mr. **Stepner**. I think railroads are entitled to merge, providing that there are adequate safeguards on competition. When Staggers was written, those safeguards were intended to be put into Staggers. No one thought about what was going to go on with respect to unreasonable reciprocal switching rates and closing of routes and through rates and things of that nature. But certainly we cannot go back to hundreds and hundreds of railroads in today's environment, and I think mergers have been good if the railroads do follow the intent of Staggers and provide for adequate competition.

Senator **Exon**. Anything to add to that, Mr. Anderson?

Mr. **Anderson**. As long as the safeguards Paul is talking about are put in, great. Our look at the UP and the BN mergers, in both cases they opened up additional markets. The way the mergers were applied to captive shippers they could then get into additional markets, and undoubtedly they will be at a better rate since the passage of Staggers. So we do have some additional marketing opportunities. However, if we had been in grain merchandising, instead of grain storage, we might have been able to see or give you a better experience level on the mergers.

Senator **Exon**. Thank you.

Thank you for coming, and thank you, Mr. Chairman.

Senator **Danforth**. Senator Kassebaum?

Senator **Kassebaum**. Thank you, Mr. Chairman.

Well, Senator Exon and I share some of the same interests, and I hesitate, Mr. Chairman, to have you think that it is these parochial interests that cause us then just to come to the hearing at that particular time. Many of the questions I would have have been along the same lines as Senator Exon's.

I guess I was interested in the comment, Mr. Gordon, that I understand you made, that the days of rail service to every town and elevator are over, and I think we would all agree to that and realize that the Staggers Act was a recognition of changes that are occurring.

But I also share the same concern that has been raised, and I raised it yesterday, briefly, about making sure that through the guidelines and interpretation of the ICC, we are dealing as equitably with these changes as possible, particularly, it seems to me, the necessary guidelines in the dealing of the contracts and the posting of the grain rates.

Do you view this as a problem?

Mr. **Gordon**. I think as long as I have got one and nobody else does, it is not a problem, but yes, I do. As a small, and I would consider a small shipper, we would probably be in a better position if we were aware of the rates, the actual contract rates that were being made, because it would give us a larger or better chance of bargaining.

Senator **Kassebaum**. Would the rest of the panel share that view on the posting of the rates?

Mr. **Stepner**. That is one of the main issues that is bothering the membership. We think it is extremely important that full disclosure be made of contracts. The safeguards that are written into Staggers today which supposedly permit challenge of contracts on a certain basis on agricultural commodities, are really a sham as far as the Commission is concerned since they release no information whatsoever, and it is impossible to challenge a contract on the basis of discrimination. It is a catch-22 situation.

So I think most people in the grain industry strongly support full disclosure of information in contracts on agricultural commodities. And I speak for agricultural commodities only, raw grains.

Mr. **Anderson**. Senator, I would have to agree. The only way a shipper, or especially a group of small shippers, can go in and ask for a contract is to know the information, and presently you do not have full disclosure of all the pertinent terms. So consequently, you can guess by bidding against a contract-bidder on the grain, but you really do not know the actual contract. Is the contracts advantages on equipment, leased cars, what have you.

Yes, I think that is necessary, and the ICC could do that now. I know that was one of the concerns of Senator Exon when the Staggers was passed.

Senator **Kassebaum**. I remember we debated this at that time. The ICC guideline, I think, regarding contract requirements is very broad, as far as I can see, as far as just needing to post the name of the railroad and the length of the haul and so forth, and it does not give, I think, as I look at it now, the information that is necessary to keep the competition there on a fair and equitable basis, particularly for some of the smaller operators that are trying to remain alive in the marketplace.

Senator **Exon**. If you would just yield, I think we tried very hard, but our best efforts basically went astray, I think, because the ICC does not see things as we did when we passed the law.

Senator **Kassebaum**. Well, I certainly share with you the concern on how we can better address these guidelines in directions to the

ICC as far as perhaps strengthening some interpretations of the Staggers Act.

Thank you, Mr. Chairman.

Senator **Danforth**. Mr. Gordon, is the Ritzville Warehouse a captive shipper?

Mr. **Gordon**. We do have truck barge facilities 50 miles from our operation, but pretty much we are a captive shipper in that the rates are so much less by going on the railroad that we would be considered, I guess, captive.

Senator **Danforth**. We have had a lot of testimony about the problem of captive shippers, but you were so positive about the operation of the Staggers Act. How do you account for the difference between your experience and the experience of others?

Mr. **Gordon**. Well, we do have one other option, and for one thing, we are on the main line of the Burlington Northern, which makes us a little bit different than being on some branch line. We were able to implement the unit train at, we said, $200,000. But that is fairly inexpensive when you are talking about construction these days.

So we have been able to be very competitive in our area because we were able to implement this. So we have generated considerable revenue with the railroad.

So therefore, I feel that we have had a fairly good rate.

Senator **Danforth**. I do not know if it is possible for the other panelists to do this, but I would like you to give the subcommittee your best judgment as to the number of your customers or your membership, rather, who are what you would call captive shippers on a branch line.

Mr. Stepner?

Mr. **Stepner**. I think that the National Grain and Feed Association study, while it does not take into consideration branch lines only, does show that some 94 percent of country elevators rely on one railroad for their service and can go no other way but that single railroad. That study is a demonstration of captivity of grain shippers as far as the railroad is concerned. We could make a survey on how many people are on branch lines.

Senator **Danforth**. That isn't necessary. I just wanted your ball park guess.

There is a difference between being on a main line and on a branch line, I would think, as Mr. Gordon pointed out. I mean, he is in a much more advantageous position than somebody who is way out in the country somewhere.

Mr. **Stepner**. There are situations where you have branch lines that are not profitable, and I do not think any of the grain interests are proposing that the railroads be forced forever to perform unprofitable services. I think that is another issue.

You can be on the main line of a railroad and still be captive to that railroad as far as naming of rates and services are concerned.

Senator **Danforth**. Mr. Anderson, do you have any estimate as to percentage of the industry that is off the beaten track and captive shippers?

Mr. **Anderson**. I can give you some definite figures, and I will have to guess on some of the others. Of our 856 elevators, we have 12 percent of those that are served by truck only, and the rest, 753, are served by rail. Of those, 95.1 percent are served by only one carrier. And breaking these down, I would hunch a third of them are on branch lines, another third are on secondary lines, that would now make up two-thirds of the total. We also have two main high-speed lines that can handle coal coming through Nebraska from Wyoming. They would make up the remaining third of shippers on the total mileage.

And, we have very little barge competition with rail. The only thing we have is truck, mainly moving to Kansas, by the way. So if we had what they have in the Northwest with the barge competition it would help.

Senator DANFORTH. Mr. Evans?

Mr. EVANS. For all practical purposes, between 80 and 90 percent of the phosphate industry in Florida is in fact captive.

Senator DANFORTH. Gentlemen, thank you very much.

Senator EXON. Mr. Chairman, let me make one point here. The statement that Mr. Anderson just made is particularly important, I think. We are fortunately blessed in Nebraska with two main-line railroads, as Mr. Anderson has said, but we are still experiencing difficulties. Other States that move grain do not have generally as good rail transportation as we do, I suspect would be that much worse off.

Thank you.

Senator DANFORTH. Thank you very much.

The final panel, the general shipper panel, Mr. Long, Mr. Hamer, and Mr. Archer.

Mr. Long?

STATEMENTS OF DWIGHT E. LONG, CHAIRMAN, RAIL RATES AND PRACTICES COMMITTEE, NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE, ACCOMPANIED BY JOHN F. DONELAN, GENERAL COUNSEL; T. A. HAMER, JR., DIRECTOR OF TRANSPORTATION, MEAD CORP., ON BEHALF OF THE AMERICAN PAPER INSTITUTE; AND JOHN J. ARCHER, DIRECTOR OF LOGISTICS, CROWN ZELLERBACH CORP.

Mr. LONG. Good morning. My name is Dwight Long, and I am here on behalf of the National Industrial Transportation League. With me is John F. Donelan, general counsel of the league.

Based on almost 3 years of experience, the league believes that the Staggers Rail Act is working well where competition, especially interrailroad competition, exists. In these instances, the act has justified Congress faith in the ability of the marketplace to replace governmental economic regulation.

However, we are deeply concerned about the act's effect on those shippers who do not have effective competition. To these shippers, the act's promise of a market-disciplined rail industry remains illusory.

We believe that the act's finally honed balances have been frustrated by the ICC's failure to accord its procompetitive provisions the same importance as the measure's revenue adequacy goals, and by certain industry trends which are reducing interrailroad competition, thus increasing the amount of single-carrier control over rail transportation services and over goods moving to the Nation's consumers.

We believe that unless Congress acts promptly to insure that the benefits of effective competition extend to all segments of the rail industry, there may well be a call for reregulation. Rather than limiting the railroads' managerial discretion through increased regulation, the league urges Congress to promptly address inequities in the ICC's implementation of the Staggers Act.

Issues warranting congressional review and action include revenue adequacy, rate reasonableness, exemption authority, and the fostering of competition.

With respect to revenue adequacy, the league is very concerned about how the current ICC standard affects the fostering of competition. The league believes that general business standards, rather than a special ICC standard, should be used to determine the industry's financial health. We recommend that the ICC profitability test be required to incorporate a variety of widely used financial indicators, and that the ICC's ROI standard should be modified to reflect the suggestions contained in our prepared testimony.

Concerning rate reasonableness, it appears that the ICC has allowed revenue adequacy considerations to overshadow the other congressionally mandated factors. In the recent coal rate guidelines case, which may be extended to all rail-captive shipments, the ICC set forth its latest methodology for maximum pricing, including the stand-alone cost test. The league questions this test's premise of equivalency to captive shippers having access to effective competition. We believe that competition develops more efficiencies than a shipper's providing his own rail equipment and services.

Further, the league is concerned that the Commission's interpretation of the market dominance provisions is flawed, and may adversely affect the effectiveness of the act's maximum rate safeguards. Current Commission procedures combine uncertainty with complexity and threaten to turn rate reasonableness proceedings into litigations as complex as antitrust cases. This upsets the Staggers Rail Act's balance between rate freedom where realistic competition exists, and effective regulatory oversight and relief where it is absent.

The league believes Congress should reiterate its intent that shippers should have practical, usable benchmarks for promptly determining market dominance through meaningful, universally applicable captivity tests. The league urges Congress to insure that Commission actions do not subvert the safeguards Congress designed to address the needs of captive shippers.

With respect to exemption authority, the Commission has used its congressionally granted exemption authority to reduce unnecessary regulation. However, we are deeply concerned that the ICC has recently gone beyond congressional intent, specifically in its decisions to administratively deregulate all boxcar transportation and export coal traffic. The league recommends close congressional review of these decisions to determine whether they frustrate the procompetitive aims of the Staggers Rail Act.

In regard to the fostering of competition, we believe that the railroads, with the concurrence of the Commission, have gone far beyond the intent of Congress in effecting mass cancellations of joint rates over routes which, in many cases, were principal sources of competition.

Deeply concerned about the effect that these and other types of anticompetitive cancellations are having on rail-to-rail competition, the league on February 25 asked the ICC to issue guidelines so that anticompetitive cancellations would be restricted, and the act's procompetitive provisions would be implemented. On July 7, the ICC denied the league's request.

Until Congress can evaluate the impact of these anticompetitive actions and can direct the necessary actions to insure effective interrail competition, the league recommends that the Commission be directed to approve joint rate or reciprocal switching cancellations only in instances where an economic need is proven.

In conclusion, the league believes that Congress should consider early action to ensure that the benefits of effective competition extend to all shippers. These actions include assuring implementation of the act according to congressional intent, and enacting remedial legislation, where necessary, to foster effective competition throughout the rail industry.

The league looks forward to working with the subcommittee to assure that our mutual goal of an efficient, market-disciplined rail industry is realized.

Thank you for the opportunity to speak to you today.

[The statement follows:]

STATEMENT OF THE NATIONAL INDUSTRIAL TRANSPORTATION LEAGUE

Good Morning: I am Dwight E. Long, General Traffic Manager of ICI Americas, Wilmington, Delaware. I have been involved in industrial traffic for 22 years, and have been a student of the rail industry for more than 30 years.

My appearance here today is on behalf of The National Industrial Transportation League. I am chairman of the League's Rail Rates and Practices Committee. The League is a voluntary association of 1,600 shippers, shippers' associations, boards of trade, chamber of commerce, and other entities concerned with rates, freight, and transportation services of all modes. It is the only nationwide association representing shippers of all types of commodities moved by all transportation modes. Its members, directly or indirectly, are responsible for the routing of about 80 percent of our country's commercial freight. During its more than 75-year history, the League frequently has been the spokesman for business and industry on transportation issues.

The League was an active participant in securing enactment of the Staggers Rail act of 1980. We believed that this legislation provided a workable balance between the rail industry's goal of achieving revenue adequacy and the shippers' goal of maintaining and fostering competition within the industry. We further believed that the Act effectively addressed the League's overall goal of an efficient, market-disciplined rail industry.

Since enactment of this legislation, the League has been an active participant in many of the Interstate Commerce Commission proceedings undertaken to initiate the Staggers Rail Act. Additionally, the League has and continues to be actively involved in the court cases affecting the issues under review by your subcommittee. These issues include: Ex Part No. 393, *Adequacy of Railroad Revenues*; Ex Parte No. 320 (Sub-No. 2), *Market Dominance Determination and Consideration of Product Competition*; Ex Parte No. 346 (Sub-No. 8), *Exemption from Regulation—Boxcar Traffic*; and, Ex Parte No. 445, *Standards for Intramodal Rate Competition*.

Based on almost three years of experience, the League believes that the Staggers Rail Act is working well in those areas where competition, especially inter-railroad competition, exists. In these instances, the Act has justified Congress's faith in the ability of the marketplace to effectively regulate transportation services. However, our members are deeply concerned about the Act's effects on those shippers who do not enjoy the benefits of effective competition. To these shippers, the Act's promises of a market-disciplined rail industry remain illusory.

The League believes that the Act's procompetitive balances have been frustrated by the Interstate Commerce Commission's failure to accord them the same importance as the measure's revenue adequacy provisions, and by certain industry trends which are reducing competition, thus increasing the amount of single-carrier market control over rail transportation services, and the goods they supply to the nation's consumers.

Shipper concern about these developments has been increasing, and has resulted in numerous calls for corrective action. Since last October, the League has been communicating rail shippers' concerns to Congress. At our last Annual Meeting, the membership unanimously ratified the attached position paper on this important transportation issue.

As noted in the position paper, our members believe that to realize the full intent of the Staggers Rail Act, remedial action is needed in the following areas;

Maintaining and/or restoring a joint rate system over all economically viable interchange points;

Fostering rail-to-rail competition though implementation and expansion of the Staggers Rail Act entry reforms, viz: reciprocal switching, trackage rights, and construction or extension of rail lines;

Utilization of Congressionally mandated cost tests to define non-competitive business under the effective control of the railroads;

Until effective competition is realized, continuation of federal economic regulation to assure reasonable pricing on rail captive traffic, and to assure that the use of collective ratemaking authority is in line with Congressional intent.

Unless Congress acts promptly to ensure that the benefits of effective competition extend to all segments of the rail industry, the result may well be a call for reregulation. Rather than limiting the railroads' managerial discretion through the reimposition of regulation, the League would urge Congress to address the current inequities as promptly as possible. Issues warranting Congressional review and action include revenue adequacy, rate reasonableness, exemption authority, and the fostering of competition—all of which are the subject of today's hearing.

RAIL REVENUE ADEQUACY

Prior to passage of the Staggers Rail Act, the Interstate Commerce Commission assessed the financial health of the nation's railroads by evaluating a number of indicators including certain performance ratios, the rate of return on net investment, and funds flow analysis. These ICC analyses generally conformed to those used by the financial community in evaluating the financial health of non-rail businesses. Under these tests, about half of the Class I railroads in 1980 were found to be "revenue adequate"—that is, producing sufficient profits to remain viable businesses.

Subsequent to the passage of the Staggers Rail Act, the ICC abandoned these traditional indicators, substituting the sole criterion that a carrier's rate of return on net investment should equal the current cost of capital. The result of this change is that the ICC has found, for 1982, no major U.S. railroad was "revenue adequate." This ICC finding ignores the fact that the financial and investment communities have rated many railroad stocks as "blue chip." In addition, it ignores that some railroads have been able to make multi-million dollar investments in non-rail businesses. For example, the recent $1 billion tender offer by CSX Corporation (the holding company for the Chessie and Seaboard Railroad Systems) for a gas transmission company, and the recent non-rail acquisitions by the Burlington Northern.

The Commission's choice of financial performance indices is important for it determines whether the agency is meeting its mandate to assure the revenue adequacy of the nation's railroads. As long as the Commission perceives the railroads to be in financial difficulties, shippers believe the agency's activities will favor increasing rail revenues rather than promoting rail competition.

The League firmly supports a strong, financially secure, privately owned rail system. However, we are deeply concerned about how the ICC's revenue adequacy standards affect the fostering of competition. The League believes that general business standards should be used to determine the industry's financial health, and that special ICC standards in this area are not needed.

The League recommends that the ICC rail profitability test be required to incorporate a variety of widely used financial indicators in addition to return on investment. We further believe that the ICC's ROI standards should be modified to reflect return on depreciated original cost of rail assets less deferred tax reserves and less assets not used or useful in providing rail freight service, so that the Commission's assessment of the financial health of the rail industry will more closely conform to the evaluations made by the financial and investment communities.

RATE REASONABLENESS

Where a rail shipper is unable to secure competitive service, either from another railroad or another transport mode, he is captive to the carrier currently providing him service. The League would prefer that the benefits of effective inter-rail competition extend to all shippers. However, until this goal is achieved, we realize that federal economic regulation is needed to assure reasonable pricing for users of single-source or captive rail service.

Although the Stagger's Rail Act continues to provide for ICC review of maximum rates in market dominant situations, the ICC, in a series of recent decisions, has allowed rail revenue adequacy considerations to overshadow the other Congressionally mandated issues to be used in determining rate reasonableness.

In the recent "Coal Rate Guidelines" case, which, although it purports to apply only to coal shipments, may very well be applied to all rail-captive shipments, the ICC has set forth its latest methodology for maximum pricing. It included the so-called "stand alone cost test," which would permit railroads to price their services at any level up to the cost which would apply if the shipper provided his own rail service.

The test's premise that it is equivalent to captive shippers having access to effective competition is not sound. The operation of effective competitive forces should provide more efficient rail service than if a shipper was expected to provide the rail equipment and service himself. In addition, this costing methodology could operate as an insurmountable barrier to small and medium-sized shippers seeking captive shipper protections. The lower the tonnage levels, the higher the cost per ton needed to finance the shipper's own rail service. Rates calculated in this way could be astronomical, and would be the very opposite of what would result from the presence of effective competition. In its most literal interpretation, use of this methodology could render maximum rate review meaningless, for a "stand alone" cost could be prohibitively high—particularly where shipment volumes are small.

Further, the League is concerned that the Commission's interpretation of the "market dominance" provisions is flawed, and may adversely affect the effectiveness of maximum rate provisions on captive or "market dominant" traffic. The Commission's early decision on market dominance focused on such considerations as revenue to variable cost, transportation market share, and whether or not a shipper had made a substantial investment. When challenged by the railroads, this approach was upheld by the U.S. Court of Appeals.

However, the Commission later reversed itself by discarding the previous considerations in favor of a case-by-case approach which tended to include consideration of extraneous and difficult-to-quantify factors such as product and geographic competition. The ICC's decision was intially struck down as not in conformity with the law, but the matter is now pending on rehearing in the U.S. Court of Appeals.

Until this matter is resolved, meaningful rate control remains an illusory goal. Current Commission procedures combine uncertainties with complexities, and threaten to turn most rate reasonableness proceedings into miniature antitrust litigations. This result upsets the Staggers Rail Act balance between rate freedom where effective competition exists and regulatory oversight and relief where it is absent. This balance reflects one of the basic goals of the Staggers Rail Act—to provide a regulatory process that balances the needs of shippers, carriers, and the public. The League believes that the Commission has concentrated disproportionately upon the desires and needs of the railroads, contrary to this Staggers Rail Act goal, and contrary to the market dominance provisions enacted by Congress.

In addition, the League would like to note that it has long been recognized that many elements can be involved in determining a rate's maximum reasonableness. The foremost factors are cost of service and value of service. In particular situations, other factors also can be present. The League believes that all relevant factors in a given situation should be considered, and that adoption of a "one and only" standard, whether a costing or pricing methodology, is an erroneous oversimplification that could operate to the detriment of rail captive shippers.

The League believes Congress should reiterate to the Commission its intent that shippers should have practical, usable benchmarks for the determination of rail "market dominance," through specifying meaningful, universally applicable tests for rail captivity. The League would urge Congress to ensure that this new stand alone methodology, if employed in any way by the agency, not be used to subvert the safeguards Congress designed to address the needs of captive shippers.

EXEMPTION AUTHORITY

Since enactment, the Commission has utilized its Congressionally mandated exemption authority to effectively reduce unnecessary regulation. The League firmly supports the elimination of unnecessary federal regulation. However, we are deeply concerned that the ICC is not now exercising its exemption authority in accordance with Congressional intent.

Within the last six months, the Commission has elected to administratively deregulate, by use of this exemption authority, boxcar transportation and export coal traffic. These actions were taken despite the fact there are significant questions about whether marketplace forces are sufficiently strong to function as Congress envisioned.

With respect to the boxcar exemption, the League is concerned that this decision, if permitted to take effect, could well deprive captive shippers of their Staggers Rail Act rights. We believe that this decision makes no serious effort to analyze the impact upon relevant markets or upon the categories of shippers who do not enjoy the benefits of effective competiton.

In addition, this decision proposes radical changes for car service and car hire. It ignores the substantial equipment investments made by carriers, including shortline and regional carriers, and by leasing companies, many of whom anticipate serious financial problems if this decision was allowed to take effect. It is quite possible that this decision could result in a sharp deterioration in rail service and in an undermining of the unified, cooperative national rail system. The League does not believe that the Staggers Rail Act intended to effect such radical and harmful changes. We further believe that the Commission far exceeded the limits of the exemption authority granted under 49 U.S.C. 10505.

With respect to the export coal decision, the League is concerned about the adverse effects this decision will have on shippers, especially captive shippers. Our position was more fully elaborated in our submission to the ICC on this matter. As in the boxcar decision, we believe that the agency far exceeded the limits of the exemption authority granted under 49 USC 10505.

The League would recommend close Congressional review of these decisions to determine whether these decisions thwart the procompetitive aims of the Staggers Rail Act.

FOSTERING COMPETITION

The League supported the Staggers Rail Act provisions establishing mechanisms to cancel noncompensatory joint rates and to increase them to compensatory levels. However, the League believes that the railroads, with the concurrence of the Commission, have gone far beyond the intent of Congress in effectiving mass cancellations of joint rates over routes which, in many cases, were principal sources of competitive service. Indeed, evidence has been developed by both affected rail carriers and shippers showing that many cancelled rates applied over routes which were more economical and provided superior service to the uncancelled routes.

The League supports rail industry efforts to improve operational efficiency. However, the League opposes the closing of economically viable routes when the practical effect is to reduce competition and to increase shipper captivity to single sources of supply for rail service.

Deeply concerned about the effect these and other types of cancellations were having on fostering rail-to-rail competition, the League on February 7 asked the ICC to issue guidelines and a policy statement so that anticompetive cancellations would be prohibited, and the procompetitive provisions of the Staggers Rail Act affecting reciprocal switching arrangements, joint use of terminal facilities, and other access issues, could be implemented. This request was docketed as Ex Parte No. 445.

After The League filed a petiton for expedited action, the ICC on July 7 denied the League's request. The League is deeply concerned about the Commission's failure to seriously address these important policy questions—especially in light of the agency's actions affecting railroad revenue adequacy.

Until Congress evaluates the impact of these cancellations, as well as those affecting reciprocal switching arrangements and other procompetitive issues, and takes the necessary actions to assure their effective implementation, the League would recommend that steps be taken to ensure that the Commission approves cancellations only in those instances where there is a demonstrated economic need.

CONCLUSION

In conclusion the League believes that the Staggers Rail Act has worked well in those situations where competition, especially inter-railroad competition exists. However, this Act has been less successful in those instances where shippers do not enjoy the benefits of effective competition.

The League believes that Congress should consider early action to assure that the benefits of effective competition extend to all segments of the rail industry. We believe that these actions include assuring that the Commission is implementing the Act according to Congressional intent as well as taking such legislative actions necessary to foster effective competition throughout the rail industry. We would urge Congress to consider the remedial actions we have outlined and to consider early action to ensure that the procompetitive goals of the Staggers Rail Act are realized.

The League looks forward to working with the subcommittee to assure that our mutual goal of an efficient, market-disciplined rail industry is realized. We thank you for this opportunity to present our views.

LEAGUE POSITION ON ADDITIONAL REFORM FOR THE RAIL INDUSTRY

The League supported the objectives of the Staggers Rail Act of 1980, because we believed the legislation would balance the needs of shippers, carriers and the public. However, the League is concerned about changes in this industry's competitive environment and some emerging anti-competitive practices which require administrative and/or legislative remedy.

Specifically, the League cites:

(1) Restrictive routing practices by carriers;

(2) Failure to implement entry reforms such as reciprocal switching, trackage rights and extension of rail lines;

(3) Lack of effective protectin for captive traffic;

(4) Absence of a productivity pass-through characteristic of a competitive system.

To realize the intent of the Staggers Rail Act, the League would recommend the following areas as subjects for remedial action:

(1) Maintaining and/or restoring a joint rate system over all economically viable gateways;

(2) Fostering rail-to-rail competition through implementation and expansion of the Staggers Rail Act entry reforms, viz: reciprocal switching, trackage rights, extension of rail lines;

(3) Utilization of Congressionally mandated cost tests to define non-competitive business under the effective control of railroads;

(4) Until effective competition is realized, continuation of federal economic regulation to assure reasonable pricing on rail captive traffic, and to assure that the use of collective ratemaking authority is in line with Congressional intent.

Senator **DANFORTH**. Mr. Hamer?

Mr. **HAMER**. Thank you, Mr. Chairman.

My name is Theodore Hamer. I appear for the American Paper Institute, the national association of the pulp paper and paperboard industry. The members of our industry are among the principal users of rail transportation.

API has been a consistent supporter of deregulation of the railroad industry wherever competitive forces are present. API is of the view that effective competition will protect shippers, but has stressed the continuing responsibility of the Interstate Commerce Commission when such competitive forces are not present.

I want to emphasize two problems with which we are here particularly concerned, one, the harmful impact of the boxcar deregulation issue upon shippers, and two, the anticompetitive cancellation of joint rates and through routes.

First, the boxcar issue. The recent decision by the ICC footnoted with vigorous dissent by Chairman Taylor, proposed to deregulate boxcar transportation insofar as rate regulation is concerned, and also, to alter the car hire arrangements as well. Lest there be any misunderstanding, captive shippers are enormously concerned about both rate deregulation and the car hire service aspects of this boxcar decision.

Our industry, the largest user of boxcar transportation, views the decision as a total disaster. Railroad transportation pricing, car hire compensation, and car service are inextricably and unavoidably interrelated. We find the decision totally unacceptable on all of these fronts.

Under the ICC decision, captive shipper would be left without protection, directly contrary to the intent of the Congress. The boxcar deregulation decision overlooks the impact on boxcar shippers who are confronted with railroad market dominance. The decision completely overlooks the frequent situation in our industry where shipments involve relatively long distances with heavy loads. Here there is simply no effective competition, and railroad market dominance exists. The careful work of the Congress designed to protect shippers exposed to railroad market dominance would be eliminated by this decision.

Turning now to the cancellation of joint rates and routes and gateways, programs mounted by certain major railroads are causing a reduction in competition among the railroads, contrary to the objectives of the Staggers Act. I refer to the joint rate and through route cancellation and the closing of gateways by the Seaboard Railroad, Southern Pacific, and Conrail. Other railroads have retaliated. In many instances shippers have been left with massive cancellations involving hundreds of routes and rates blanketing wide geographical areas. Many of these cancellations are anticompetitive in nature. In our opinion, their primary purpose and effect is to suppress competition from other railroads and thereby deprive shippers of the competitive opportunity to utilize the cancelled routes and rates.

By its refusal to institute a rulemaking proceeding addressed to anticompetitive actions, the ICC has shown an indifference to the objective of Staggers to maintain and promote competition among the railroads.

In conclusion, one of the great assets of this Nation is our unified, operationally coordinated national railroad network. Its destruction would be an enormous loss. The ICC must change its approach and commit itself to carrying out the procompetitive objectives of Staggers and to providing the protection for captive shippers that Congress intended. Otherwise, the substantial deterioration if not actual destruction of that unified nationwide rail system is inevitable.

Thank you, Mr. Chairman.

Senator DANFORTH. Mr. Archer.

Mr. ARCHER. Mr. Chairman, thank you very much for the invitation to come to speak to you.

I am director of logistics for Crown Zellerbach Corp. with headquarters in San Francisco. Crown is a fully integrated forest products company and packaging company with locations throughout the United States. We use rail, water, truck, and air transportation, and about 40 percent of our domestic transportation freight bill of $200 million goes to the railroads.

What I would like to do is just tell you our policy. We are in favor of very sound railroads to give us the service we need. To use your example of the tree and the limbs, what we are afraid is that if you cut the trunk of the tree, all the limbs die, and we want to be sure that there is a sound trunkline system of railroads in the United States to serve us.

Our company is in favor of deregulation, and I would like to share with you some of our experiences during the last few years since Staggers.

No. 1, we ship about 10,000 trailers on flatcars via railroad today. This is a tremendous increase. It comes off the highways, and also it comes from boxcars. Where railroads now are deregulated in TOFC, they are becoming much more aggressive in their rate practices and have in fact reduced substantially the number of boxcars that are moving in the United States. Specifically, at one time we moved all of our products from Portland to St. Louis, our facilities in St. Louis, by rail boxcar. Today that is all going piggyback.

As far as contracts are concerned on boxcars, we have more than 20,000 boxcars a year that we ship, and about 50 percent of those are under contract. We find these contracts to be exceptional for us. We can bilaterally negotiate agreements with railroads. In fact, in one particular case the railroad runs a train for us daily, 5 days a week, from Portland to Los Angeles, in 48 hours, and this was put in specifically to take trucks off the highway and put them back into boxcars. And in the second quarter of this year, we had about 2,000 boxcars on those special trains.

So our experience has been a very positive one with deregulation of TOFC and with contracts in boxcars.

Now, when it comes to the question of complete boxcar deregulation, it affects two areas: one, the maximum rate issue, and the other is the car service and car hire agreements. Our experience is that the class I railroads are not building boxcars, and going down the road, we are going to have a complete disaster as far as class I railroads are concerned.

It seems to me that the small railroad, all the limbs, are building all the boxcars for the few favorite shippers who happen to be situated on those short line railroads. But the vast majority of America is on the major trunk lines, and those railroads cannot build boxcars, at least by their own statements.

What I think this committee needs to do is address that issue. I am very sympathetic to the short lines, and of course, they need some protection, but the real issue is how do you get the major trunk line railroads to build boxcars, because that is where the substantial transportation in this country is taking place.

As far as the maximum rate limitations are concerned, we, too, here are in favor of deregulation. We feel that that is the most efficient and fastest way to bring about changes that are needed and a reversal of the trend of many years in reduction of boxcars in the United States by the class I carriers.

In summary, Mr. Chairman, I should point out that my company has tried to take a consistent position in support of deregulation throughout the transportation field, whether it be rail, truck, or water. We recognize, of course, that regulation cannot and should not be avoided in matters affecting health and safety. But our free market system has far too many variables to be effectively managed through the Federal Register without paying a very high economic cost.

We think the Congress and the administration have been moving in the right direction, and we encourage you to continue in that path.

Thank you.

[The statement follows:]

STATEMENT OF JOHN J. ARCHER, DIRECTOR OF LOGISTICS, CROWN ZELLERBACH CORP.

My name is John J. Archer. I am Director of Logistics for Crown Zellerbach Corporation whose headquarters are located in San Francisco, California. Crown Zellerbach is a fully integrated forest products company engaged in the manufacture and distribution of woodpulp, paper, paperboard, logs, lumber, plywood, poles, corrugated containers and flexible packaging. Our pulp, paper and wood products mills are located in the states of California, Louisiana, Mississippi, New York, Oregon, and Washington. In addition we have film products, paper and paperboard converting plants located throughout the country.

Crown Zellerbach's sales in 1982 were $2.9 billion. It employs about 20,000 people. Crown Zellerbach's total transportation expense in 1982 was $300 million. Crown Zellerbach utilizes rail, truck, water, and air transportation to distribute products. About forty percent of its domestic transportation expense is for rail service.

HAS DEREGULATION CHANGED THE RAILROAD INDUSTRY?

Immediately prior to deregulation, the railroad industry was not able to serve its customers properly nor perform the services that were expected of this great industry. Railroad service had deteriorated so badly that shippers diverted business to highway carriers in order to satisfy their customers' delivery requirements. We had numerous cases of long rail transit times, train wrecks, lost boxcars, and a multitude of similar types of operational problems. Fortunately, Congress recognized the rail industry was in trouble and passed legislation that began to restore the railroads as an effective force in the infrastructure of our economy. At Crown Zellerbach we find your formula has worked. Railroads are upgrading their main lines, abandoning light density track and moving trains on schedule. They have become increasingly responsive to the needs of shippers. Crown Zellerbach has increased its utilization of railroads significantly. Our customers and senior management are happy with the results. We are receiving better service from the railroads and, at the same time, our costs are reduced because we no longer use highway carriers where railroads have a competitive advantage. Furthermore, there may be important benefits to our aging highway system resulting from reduced truck traffic and significant energy savings as well.

Some of the results of our experience with deregulation can be identified. During 1982, we shipped approximately 10,000 trailers on flat cars for which the railroads compete vigorously in a deregulated environment. Many of these shipments would have moved by motor carrier before Trailer-On-Flat-Car traffic was deregulated.

We also have examples of the results of rail contracts which is another form of deregulation. Our boxcar traffic is covered extensively by contracts for rates and services. We now ship about half of our rail traffic volume under contracts. These contracts contain automatic price escalators so we can forecast rate levels more accurately than in the past. Some contracts provide us with daily train service from Portland, Oregon to Los Angeles. During the second quarter of 1983 we moved 2,038 boxcars on these special trains. This outstanding rail service was instituted to meet truck competition. At the time of its inception, we paid annual freight revenue to highway carriers in the West Coast traffic lane in excess of ten million dollars even though railroad freight rates were lower than highway. So, rather than reduce its rates the railroad provided a service incentive to divert the traffic to their mode. Our need was for quick, dependable delivery from mill to marketplace to reduce inventory costs and improve customer service. The railroad, seeing an opportunity for increased revenues, and having the flexibility to develop a fresh approach, presented us with an excellent solution.

In our opinion these examples emphasize the value of deregulation where innovation and marketing is applied bilaterally without the restraint of a cumbersome regulatory process. Within the shipper community I have heard many accolades about piggyback deregulation and railroad rate contracts. Therefore, I conclude that deregulation has benefited the general public.

BOX CAR DEREGULATION

In spite of the favorable results of TOFC deregulation and contract deregulation, the issue of complete boxcar deregulation is generating a lively debate among user groups. The general subject can be subdivided into two areas of concern. The first covers car service and rental practices. The second centers around maximum rate regulation or protection of the captive shipper. I will discuss these subtopics separately.

Car service and car hire agreements

It is well known that Class I railroads are reducing their boxcar fleets both in number of cars and the gross carrying capacity of the total fleet. Generally, revenues under current regulations are not sufficient to justify investing in more boxcars. Railroad executives state unequivocally that they may never build another boxcar. In fact, this statement has been repeated for the last five years. One railroad was ready to concede that its marketing philosophy would be narrowed to products that were bulk, raw materials and non-service sensitive products. Other railroads are supporting an expanded piggyback service as a substitute for boxcars. However, new piggyback systems are limited in scope because they center around hub cities to permit railroads to focus efforts on certain traffic lanes. This is necessary to compete effectively with highway carriers. My experience with regulation of boxcar rates and services leads me to the conclusion that the boxcar problem will continue if past regulatory practices continue. Present regulation of boxcar service and car hire agreements have created periods of car shortages and inequities of car supply between Class I railroads and short lines. National uniform car service rules have not created an efficient distribution of boxcars. More importantly, they have been counterproductive and act as a disincentive to major Class I railroads to build boxcars. The same national regulations make it profitable for short line railroads to build freight cars if the cars operate off their lines to generate per diem revenue. It is a strange paradox that Class I railroads serving most American industries cannot justify boxcar building programs while the regulations permit short line railroads to build cars profitably. Therefore a few shippers located on short lines are well served while the majority suffers.

I cannot comprehend how a single national set of rules can regulate car service and car hire equitably for all shippers and railroads throughout the country. The marketplace should be the principal regulator. Car rental and freight rates must work together to justify car building programs.

There is a great fear that another catastrophic car shortage will arrive just as they have periodically for over one hundred years. Some shippers want protection from the ICC so cars can be spread equitably. I have appeared before the ICC myself during these car shortage periods. It was my personal experience that the ICC felt frustrated by the fact that this problem was placed in their lap. After all, they did not own a single boxcar but were being asked to put out the fire after it had engulfed the building. On the other hand, boxcar deregulation will lead to a more logical economic system that can reduce the peak shortages and take pressure off the ICC. Railroads will use their rate freedom under deregulation to raise prices during peak demand periods. This action will reduce demand. Shippers will make the economic decision to use highway transportation if railroads do not provide cars at a competitive rate level. This flexibility to price traffic during peak demand periods is essential to solving the peak boxcar shortage problem. Every competitive industry in the country operates under this pricing mechanism—except the railroads.

Deregulation will also permit railroads to solve their division problems, and per diem and car rental problems. The market place will regulate payments for movement of loaded and empty boxcars. Empty miles on the nation's railroads will be reduced, and these efficiencies will benefit the railroads and the public. Deregulation is the most efficient method available to resolve these problems. I encourage the Congress to recognize this need and give the deregulatory process sufficient time to show results.

Maximum rate regulation

The subject of maximum rate regulation is a concern of many shippers who feel railroads will charge exorbitant rates on captive traffic. Some industries voiced concern for the captive shipper. A recent Senate bill would protect captive shippers by capping rates at a certain percentage above costs. My company has many rail captive traffic lanes although I would estimate that the majority of our shipments have truck or water competition as a reliable competitive force. Therefore, we have experience with both types of traffice. Railroads must compete vigorously for competitive traffic so the high fixed cost of common facilities can be spread over a large base of traffic. In the long run all shippers will pay less. Railroads must charge a larger portion of their fixed costs to captive traffic because they must charge lower rates to attract competitive traffice. If the railroads are forced by law or regulation to hold rate at predetermined levels of profitability for the captive shipper it will be impossible to set other rates low enough to compete against highway carriers. This situation existed in recent times. Railroads were forced to raise rates with general freight rate increases. This action permitted highway carriers to be the dominant force in intercity traffic. Railroads must be selective if they are to retain and build a larger traffic base. A maximum rate formula would be counterproductive by reducing the traffic base. As a result the captive shipper will pay more eventually because competitive traffic will be diverted to highway and water carriers.

In conclusion, Mr. Chairman, I should point out that my company has tried to take a consistent position in support of deregulation thoughout the transportation field whether it be rail, truck, or water. We recognize, of course, that regulation cannot and should not be avoided in matters affecting health and safety, but our free market system has far too many variables to be effectively managed through the Federal Register without paying a high economic cost. We think the Congress and the Administration have been moving in the right direction, and we encourage you to continue along this path.

Senator DANFORTH. Gentlemen, thank you very much.

There is a vote on the Senate floor which coincides with the end of the testimony of the last panel of witnesses. Therefore, I am not going to ask you prolonged questions because I do not think it is fair to you or anybody else to keep you here while I go over. I think there are going to be two back-to-back votes, and it would be about a half an hour before I would be able to return.

But I do want to just ask a single question and to get your reaction to it.

This concludes 2 days of oversight hearings on the Staggers Act. The 2 days of hearings have consumed about 6 hours. They have been very good days of hearings. We have had a lot of testimony, strong advocacy for a variety of positions, and a good amount of very balanced testimony as well. They have been very, very helpful hearings.

Now the question is, What do we, as Members of the Senate, do? I would say that there are three basic lines we could pursue. The first possibility would be to legislate. That is, we could go back to our staffs and the committee staff, look through the testimony with a view to trying to put together a bill which would, in one way or another, address the problems that we have been considering.

The second possible approach would be not to legislate, but to lean on the ICC to view the question of the Staggers Act as one that has already been settled in legislation, but one in which there may be some regulatory problems. In leaving the issue in the regulatory as opposed to legislative arena, we could write letters, make phone calls, and continue to be very active with respect to dealing with the ICC.

The third and final possibility would be for the members of this committee to do nothing, that is, to say thank you very much and it has been a good hearing, and we know more about the Staggers Act than we knew before, and how it is operating, but the best thing we can do is really not do anything.

I would like your views, because this has been a balanced panel. There have been critics, there have been advocates, and people in between, on this particular panel, and I would like your words to the members of the committee as to which of the three approaches we should take, legislate, lean on the ICC, or do nothing.

Mr. Long?

Mr. **Long**. The league would prefer that the first and second approaches be taken. We would look forward to working with your staff in developing legislation that would clarify Congress goals for the Staggers Rail Act. We think that the third alternative would be tragic, and would be an abdication of congressional responsibilities.

Senator **Danforth**. Mr. Hamer?

Mr. **Hamer**. Mr. Chairman, my personal view is I think the Commission, since the enactment of the act, has changed its interpretation to the point now where the majority seems to be intent on dismantling regulation, period. I think, as I heard the chairman yesterday express himself, he was intent on administering the act, but unfortunately he finds himself in the minority on the ICC.

I think perhaps in joining with Mr. Long's comment, it may be a combination of exhortation that the intent of the Congress simply is not being carried out, and if it could not be, that additional legislation would be forthcoming.

Senator **Danforth**. Mr. Archer?

Mr. **Archer**. Mr. Chairman, speaking specifically on the boxcar deregulation, I would say that you should give the ICC an opportunity to rule in this matter, which I understand they will do either later this year or early next year, and to give them that chance to continue the deregulation process. If there are substantial problems thereafter, as a result of things in actual practice, then I think the Congress should act.

I do not think it would be wise to act before there are problems before us.

Senator **Danforth**. Gentlemen, thank you very much. Thanks to all the participants.

That concludes the hearing.

[Whereupon, at 11:50 a.m., the subcommittee recessed subject to the call of the Chair.]

STAGGERS RAIL ACT OF 1980

THURSDAY, SEPTEMBER 1, 1983

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Hutchinson, Kans.

The subcommittee met, pursuant to notice, at 9 a.m. at Regency rooms 1 and 2, Holidome, 1400 Lorraine, Hutchinson, Kans., Hon. Nancy L. Kassebaum presiding.

OPENING STATEMENT BY SENATOR KASSEBAUM

Senator KASSEBAUM. The hearing will please come to order. Can everybody hear all right in the back? It is getting better, I think. Thank you. It is a pleasure to welcome everyone this morning. This is an official hearing of the Surface Transportation Subcommittee of the Commerce Committee, and I am very appreciative of those who have agreed to be witnesses this morning in our continuing oversight review of the Staggers Act and the pros and cons of rail deregulation.

We held 2 days of hearings in Washington in July and at that time did discuss briefly the effects of the Staggers Act on grain transportation, but it was not the major focus of the hearing, and today that, indeed, is the focus. Primarily we will analyze the guidelines and procedures which have been adopted in respect to the contracts which may now be entered into between railroads and shippers.

The witnesses will be testifying on the effects of joint rate cancellations, as well as the contracts, branch line abandonments and reciprocal switching agreements.

The efficient and economical movement of grain is vital to the interests of our State and other States primarily involved in grain trade, and we simply must insure that the Staggers Act is working as Congress intended.

This morning I would like the witnesses to keep in mind a few alternatives that have been suggested to alleviate what some see as a problem in the areas of contracting practices under Staggers. The most drastic of these alternatives would be to eliminate in areas of grain the ability of railroads to enter into contracts with shippers. This obviously would mean losing whatever benefits such contracts have provided both to shippers and to the railroads. Another alternative would be to force a disclosure of more of the terms of the contracts. I would like to know on one hand what shippers think they could do with this information and on the other hand what the objections would be of the railroads to such disclosures. Closely coupled with this last alternative is a suggestion that the antidiscrimination provisions of Staggers be strengthened. This would probably not do a lot of good without more extensive disclosures.

I would like to suggest for procedures this morning, which would be a little bit different than the more formal aspect of the Washington hearing, that those testifying keep their remarks very brief and then we have an exchange as much as possible between the differing points of view. I am particularly pleased that the Chairman of the Interstate Commerce Commission, Reese Taylor, is here and will, after his testimony, be sitting up front and participating in the debate back and forth.

Invitation was extended this morning to the entire Kansas delegation. Commitments elsewhere prevented others from attending, and I have a statement from Congressman Pat Roberts that I would like to make a part of the record.

[The statement follows:]

STATEMENT OF HON. PAT ROBERTS, U.S. REPRESENTATIVE FROM KANSAS

I commend you for convening this oversight hearing on the Staggers Rail Act of 1980. The Staggers Rail Act was passed by Congress in an effort to reduce the burdensome intrusion of Federal regulation into the operation of railroads. However, little thought was given to the impact that the Staggers Act would have on the farmers in rural areas dependent upon railroads for the shipment of their grain to market.

At the time the Staggers Act was passed proponents of the bill argued the over-regulation of the railroad industry was responsible for a low rate of return to railroads. Opponents argued that close railroad regulations was needed to protect captive shippers, that is, grain shippers on branch lines, from unwarranted freight rates.

Three years have passed since these arguments were made and oversight by the Congress is needed to determine just what has been the impact of the Staggers Act. Last year, the USDA issued an assessment of the impact of the Staggers Act and the Motor Carriers Act of 1980, which for the most part was inconclusive in its findings. Currently, the Office of Transportation at the USDA is gathering additional information in an effort to update the study.

The National Grain and Feed Association has just recently completed an extensive survey of the nation's grain transportation system. The survey found that: Grain elevators dependent on a single railroad for service receive approximately 57.7 percent of all the grain sold by the farmer; at country elevators with rail service, 94.3 percent of them are served by only one carrier.

The above facts point out that the farmers of this Nation, as well as the small country elevator have a vital financial stake in maintaining a competive transportation system to market grain. How well the Staggers Act is working is an extremely important question to the Kansas wheat farmer simply because over two-thirds of his crop must move into export channel via railroads or truck.

Just last week I completed a listening tour of the 58 counties I represent. At several stops on the listening tour I heard from farmers and elevator operators who expressed concern over the current rail and truck transportation system and the fact that with Staggers we have a very unstable situation in terms of competition, freight rates, and captive shippers.

I encourage the subcommittee to continue extensive oversight into the impact that the Staggers Act is having on the farmer, country elevator, and rural America. I would encourage you to look into whether the Staggers Act will lead major structural changes in the grain marketing and handling system.

I will be pushing for hearings on the House side on the Staggers Rail Act. It is essential that Congress protect and maintain a competitive and viable farm to market transportation system. Indeed, legislation amending the Staggers Act may be needed to maintain and insure the survival of a competitive grain marketing, transportation, and handling industry.

Senator **Kassebaum**. It is a special pleasure to welcome Governor Carlin and Congressman Glickman who will be giving opening remarks. Governor Carlin.

STATEMENTS OF HON. JOHN CARLIN, GOVERNOR OF KANSAS; AND HON. DAN GLICKMAN, U.S. REPRESENTATIVE FROM KANSAS

Mr. **Carlin**. Thank you, Senator Kassebaum and Congressman Glickman, Chairman Taylor. Three years ago I testified before Congress on the Staggers Rail Act of 1980. My position then was that while some reasonable regulatory reforms of the rail transportation system were necessary and desirable, it was also important when implementing rail deregulation to provide some safeguards for the economic well-being of the many small grain shippers and of the midwestern farming communities where country elevators have historically played such a vital role. My position is the same today.

An examination of the actual experiences of the small grain shippers and the new condition imposed by the act indicates that it is time for Congress to consider what additional safeguards may be needed in order to ease the burden which deregulation has imposed upon that segment of the agricultural economy. In Kansas the grain industry cannot survive without reliable, efficient transportation provided at reasonable rates, and the rail carriers are an indispensable element of that equation. At the same time, it is my firm belief that the rail industry as we know it in Kansas today cannot survive unless grain and farm products continue to provide a substantial component of the total rail freight traffic in the State.

Two important ingredients which help to form this interrelationship between grain and rail are the country elevators and the branch lines by which many of those elevators are served.

In the post-Staggers period, the large regional subterminals have assumed a larger role in grain marketing and new subterminals have been developed such as the one at Colby, Kans. While these subterminals have provided some welcome economic development in their particular communities and have created some operating efficiencies for the rail carriers that service them, they have also taken a substantial amount of business away from small country elevators.

When a branch line is closed, the negative effects extend beyond the grain elevators through the local communities. Consequently, I must give serious scrutiny to any act or proposal which appears to heighten the possibility of branch line abandonments.

An additional factor which the State of Kansas must consider and one which is of increasing concern both at the State and local levels of government is the increase in heavy truck traffic upon our roads and highways. The increase inevitably results whenever freight formerly handled by rail branch lines is by necessity shifted to motor carriers. It is clearly an important goal in the State's transportation planning to continue to utilize to the greatest extent possible the existing rail lines in Kansas at their present level of service. Beyond the compelling interest in preserving the highway system, this policy has been developed during my administration to serve a number of important interests, including rail employment, energy conservation and the economic stability and continued development of many communities throughout the State that historically have been served by railroads.

My administration has taken a number of steps in pursuit of the goal of rail service prseservation that you, Senator and Congressman, are quite familiar with and which your assistance along with the entire delegation has been most helpful. These successful efforts by the State of Kansas working in cooperation with public officials at the Federal and local levels are recent development which require the adoption of several statutes and of a State constitutional amendment, as well as the availability of Federal programs which largely have funded our activities. Now as these projects near completion and as Congress continues to phase out the funding programs, Kansas along with many other States stands at a crossroad. We see the actions of Congress and of the Interstate Commerce Commission in furtherance of a policy of deregulation, and we neither disagree with that broad goal nor desire as a State to impose new burdens on the rail industry in place of those which have been lifted. However, we cannot permit deregulation in Kansas to result in a wholesale abandonment of the branch line rail system.

Therefore, my primary purpose in coming before the subcommittee today is not to propose a comprehensive package of adjustments in the complex statutory scheme in which the Staggers Act has become a part, but rather to emphasize and to call to the subcommittee's attention the very vital role which grain producers, grain shippers, rail branch lines and the communities which they serve all play in the State's economic and social structure. Moreover, I want to point out that the system I have described is clearly being shaken by the implementation of certain aspects of deregulation and to warn that not all of the effects are positive or what Congress may have intended.

With these thoughts in mind, I urge the subcommittee to give full consideration to the reforms in ratemaking, in contract rates, in contract term disclosures and other matters which representatives of the grain shipping industry are here today to propose. I ask that you attempt once again to balance the interests of the rail carriers, the large and small shipper, the grain producers and other rail users and the public to develop such amendments to the statute as may be necessary to achieve that balance.

At a minimum, Congress should establish appropriate requirements for more extensive disclosure of contract rate information. The current requirement that proof of discrimination be shown before disclosure can be mandated is unworkable. It gives neither the shippers nor the State public service commissions and departments of transportation an adequate opportunity for review.

I appreciate the efforts which the subcommittee has undertaken to include the grain industry in the current review of the Staggers Act. And I certainly thank you, Senator Kassebaum, in particular for your role in providing this forum for Kansans involved in the grain industry to comment upon how the Staggers Act has affected them. Thank you very much.

[The statement follows:]

STATEMENT OF HON. JOHN CARLIN, GOVERNOR OF KANSAS

Four years ago I testified before the Subcommittee on Surface Transportation concerning Senate Bill 796, the proposed Rail Deregulation Act of 1979. The concerns which I expressed at that time, regarding potential adverse effects of such legislation upon the grain-producing economies of Kansas and other States, were reiterated the following year in reference to similar provisions enacted as a part of the Staggers Rail Act of 1980. My position then was that while some reasonable regulatory reforms of the rail transportation system were necessary and desirable, it was also important when implementing rail deregulation to provide some safeguards for the economic wellbeing of the many small grain shippers and midwestern farming communities in which the country elevators have historically played such a vital role.

Congress appears to have considered the warnings voiced about the harmful effects of deregulation upon smaller shippers, by providing certain safeguards in the Staggers Act. However, now that the act has gone into effect, and has been interpreted and applied by the Interstate Commerce Commission, and now that rail carriers, motor carriers, grain shippers, and grain producers have begun to understand and adapt their behavior in response to the new rules of the game, the time has come to more carefully assess the effects of deregulation upon rail users who historically have depended upon the concept of the railroads as common carriers, and have located and invested in facilities in reliance upon that traditional relationship. An examination of the actual experiences of smaller grain shippers operating under these new conditions indicates that it is time for Congress to consider what additional safeguards may be needed in order to ease the burden deregulation has imposed upon that segment of the agricultural economy. This process should produce a better balance between the interests of the small shippers, grain farmers and their farm communities, and the interests of the railroads, the motor carriers, and the larger regional grain shippers who are reaping the benefits of deregulation.

The rail transportation system is of great importance to Kansas and my administration has taken a number of actions in the past 5 years to aid and encourage the development of rail service in Kansas. The railroads are a key component of the state's system of transportation,and we hope that under the favorable conditions created by the Staggers Rail Act, rail carriers serving Kansas will be able to achieve economic stability.

Also of tremendous importance to Kansas is the grain producing and marketing system. In Kansas, the grain industry cannot survive without reliable, efficient transportation provided at reasonable rates, and the rail carriers are an indispensible element of that equation. At the same time, it is my firm belief that the rail industry, as we know it in Kansas today, cannot survive in the long run unless grain and farm products continue to provide a substantial part of the total rail freight traffic in the state. Two important factors which help to form this interrelationship between grain and rail are the country elevators and the branch lines by which many of those elevators are served.

It is not only small shippers, however, who depend upon these branchlines and the business which the surrounding grain producing farms provide them. In many instances, the economies of the communities where small grain shippers are located would be devastated if they were to lose the business activity and the employment generated by the marketing and shipping of grain from local elevators, as well as the use of local rail service for industrial and commercial purposes. This rail service, at best, would be difficult to restore should a decline in local loadings of grain result in abandonment of service by the rail carrier.

In the long term, such abandonments might well result in substantial losses of freight service competition to the regions formerly served by the branch lines, and could lead to unreasonably high costs for all freight shippers in these regions. The impact of increased transportation costs would be felt by farmers in the prices they must pay for their fertilizer and farm equipment, by small industry in the costs of importing materials and exporting finished products, and by merchants and consumers in communities along the branch lines in the prices of retail goods. The short-term gains some grain producers may now be experiencing by trucking their crops to regional terminals can foreseeably be outweighed in the future by the severe effects abandonment of branch line service would have upon their communities.

Many factors play a part in branch line abandonments, and it is too early to determine to what extent the scenerio I have described is coming about in Kansas as a result of deregulation. However, the following figures on abandonment illustrate a trend that cannot be ignored:

Rail line abandonments in Kansas

	Miles
1947-49	20.4
1950-59	267.5
1960-69	430.9
1970-79	402.7
1980-82	214.5

Source: Interstate Commerce Commission System Diagram Maps.

The number of miles abandoned during 1980 to 1982 is about equal to one half of the total number of miles abandoned between 1960 and 1969, the previous highest decade for abandonments in Kansas.

Rail line subject to abandonment in Kansas

	Miles
1976-80	532.26
1981-82	896.65

Source: Interstate Commerce Commission System Diagram Maps.

The number of miles identified by rail carriers for potential abandonment has also increased since enactment of the Staggers Act, and currently constitutes 13 percent of the Kansas rail system.

It is clear that abandonments and potential abandonments are increasing, and this fact is the basis for our concerns about the effects of deregulation in Kansas. The section of the Staggers Rail Act that has given the greatest cause for concern is the provision authorizing rail carriers to negotiate contract rates with individual shippers, without requiring the carriers to extend the terms, or even to disclose the terms, to other shippers. I will leave it to the grain shippers who are present here today to describe to the subcommittee their actual experiences in dealing with rail carriers in the post-Staggers environment, and to explain the effects those dealings have had upon their own businesses and their ability to offer competitive prices to grain producers. At this time, the State of Kansas is unable to compile complete information on these developing trends. This is due to the fact that much of the information currently required to be submitted to the Interstate Commerce Commission on contract rates remains confidential, so that only one side of the coin is subject to public scrutiny. Moreover, it appears that the filing requirements are inadequate, so that the ICC itself, along with the State regulatory agencies, is unable to adequately investigate the possibility of discrimination and other problems.

Despite the confidentiality of contract rates, however, the broad outlines of the situation are becoming apparent. The Kansas Department of Transportation and the Kansas Corporation Commission, in performing their rail planning and ratemaking functions, have been in touch with a number of shippers and other knowledgeable people in the grain industry. The information they have provided indicates that contract rates, in practice, are emerging as a problem for many small shippers that witnesses in the hearings prior to enactment of the Staggers Act predicted they would become. In the post-Staggers period, the large regional subterminals have assumed a larger role on the grain marketing scene, and new units of this type have been developed, such as the one at Colby, Kans. While perhaps providing some welcome economic development in their particular communities and creating some operating efficiencies for the rail carriers servicing them, these subterminals have also taken a substantial amount of business away from smaller elevators located at distances of up to 150 miles away. By dealing with rail carriers on a contract basis, large subterminals are able to reliably forecast their future transportation costs and offer higher grain prices to farmers. This has resulted in increased commercial trucking of grain from farms to large subterminals, bypassing the local elevators. The smaller shippers, in attempting to compete, are hindered not only by their inability to offer rail carriers the larger volume shipments subterminals can assemble, and by their uncertainty as to future transportation costs, but also by their inability to even determine the basis upon which their larger competitors are dealing with the railroads, and consequently to bargain effectively for contract rates themselves.

In focusing upon the plight of the smaller shippers, I do not mean to suggest that they should be singled out for more favorable treatment at the expense of other groups affected by rail deregulation. If it becomes apparent that grain-producing farmers are in fact receiving higher prices for their crops as a result of deregulation, and if such a trend continues beyond the initial period of adjustment to the Staggers Act the grain industry is currently undergoing, then perhaps the time will come that we will recognize a modification in the use of smaller elevators, and branch lines serving them, along with an increase in onsite farm storage facilities and transportation by motor carrier to subterminals, as a more efficient grain marketing and transportation system, perhaps best benefiting the Kansas economy overall. However, based upon the evidence available so far, such a conclusion is unwarranted. It remains to be seen whether such a trend would maintain a sufficient level, of competition in the system to ensure that carriers and shippers would continue to pass along to farmers a fair share of the profits derived from such efficiencies, and whether the needs of other rail users who now depend upon such branch line service would continue to be met at reasonable rates.

An additional factor the State of Kansas must consider, and one of increasing concern at both state and local levels of government, is the increase in heavy truck traffic on our roads and highways which inevitably will result whenever freight formerly handled by rail branch lines is shifted to motor carriers. This effect will occur either when the farmers themselves ship grain by truck directly to regional subterminals located on mainlines at some distance from their farms, or when country elevators switch from branch line rail service to trucking in an effort to remain competitive. One fully loaded jumbo hopper rail car carries 3,500 bushels of grain and weighs 100 tons. To transport the same volume of grain, 3.3 semitrailer trucks, each weighing 30 tons when loaded, would be required. One trip of a fully loaded semitractor trailer has the same wear on a roadway as 9,600 automobiles. The 100 tons of grain hauled by truck is then equivalent to the wear caused by 32,000 automobiles. If a branch line annually carrying 1,000 hopper carloads is abandoned, additional wear to the highways would be equivalent to the wear of 32,000,000 automobiles.

Stated another way, if we assume a particular local elevator ships 1 million bushels of wheat annually; that all of that elevator's shipments were carried by rail prior to enactment of the Staggers Act; and that in 1983 50 percent of that freight is shifted from rail to truck, the resulting 500,000 truckloads. These 500 truckloads from a single elevator would cause an additional burden upon State and local highways equivalent to that of 4,800,000 automobiles, and this problem could potentially be compounded by each of the 1,100 elevators in the State.

It is too early to project the actual dimensions of this added burden to the highways of Kansas as a result of the trend toward trucking of grain to subterminals. However, if this trend continues, the burden clearly will be substantial.

Additionally, Kansas has nearly 4,700 bridges on State roads and highways. Of those bridges, over 2,200 or 48 percent are considerd to be substandard. The cost of repairing or upgrading all of these bridges to a safe level has been estimated at $611 million. A semi truck, fully loaded with grain, weighs 40 tons; 3 percent of the bridges in Kansas are presently inadequate to safely bear such a load. Additional bridges, if subjected to increases in such loads, could be expected to incur additional maintenance costs over a period of time.

Therefore, it is clearly an important goal in the State's transportation planning to continue to utilize, to the greatest extent possible, the existing rail lines in Kansas at their current level of service. Beyond the compelling interest in preserving the highway system, this policy has been developed during my administration to serve a number of additional important interests, including rail employment, energy conservation, and the economic stability and continued development of many communities throughout the State that historically have been served by railroads.

Some of the steps my administration has taken in pursuit of the goal of rail service preservation are efforts that Senator Kassebaum and Senator Dole are quite familiar with, and in which their assistance has been very helpful. Since 1980, the Kansas Department of Transportation has administered a total $3.2 million in Federal funds received under the section 803 Local Rail Service Assistance program. When combined with the matching shares provided by the railroads, these funds when fully expended will have resulted in three rail line rehabilitation projects with a total value of $4.3 million. In addition, the State of Kansas intervened in the Interstate Commerce Commission hearings concerning the merger application of the Union Pacific, Missouri Pacific and Western Pacific railroads, and successfully advocated a position supporting that merger while requiring certain conditions for maintaining the competitive capacities of other rail carriers serving Kansas. We have also participated as a party to the Rock Island bankruptcy proceedings, where we played a role in the successful efforts to restore permanent service over 597 miles of rail line in Kansas by the Cotton Belt Railroad and the Oklahoma, Kansas & Texas Railroad. It appears that we are also very close to the successful consummation of a purchase and rehabilitation by the Mid States Port Authority of 319 miles on the northern Rock Island line serving 12 Kansas counties.

These efforts by the State of Kansas, working in cooperation with public officials at the Federal and local levels, are a recent development that required the adoption of several statutes and of a State constitutional amendment, as well as the availability of the Federal programs which largely have funded our activities. Now, as these projects near completion, and as Congress continues to phase out the funding programs, Kansas, along with many other States, stands at the crossroad. We see the actions of Congress and of the Interstate Commerce Commission in furtherance of a policy of deregulation, and we neither disagree with that broad goal nor desire as a State to impose new burdens on the rail industry in place of those which have been lifted. However, we cannot permit deregulation in Kansas to result in a wholesale abandonment of the branch line rail system, unless and until enough time has passed and enough adjustments in the States's economic structure have occurred for such a sweeping change to be implemented without causing massive harmful effects upon the State.

Therefore, my primary purpose in coming before the subcommittee today is not to propose a comprehensive package of adjustments in the complex statutory scheme of which the Staggers Act has become a part, but rather to emphasize and call to the Subcommittee's attention the very vital role grain producers, grain shippers, rail branch lines, and the communities they serve, all play in the State's economic and social structure. Moreover, I want to emphasize that the system I have described is clearly being shaken by implementation of certain aspects of deregulation, and to point out that not all of the effects are positive or are what Congress may have intended. In particular, any significant shift of freight traffic from rail branch lines to highway trucking will result in serious consequences for the state highway system. With these thoughts in mind, I urge the subcommittee to give full consideration to the reforms in ratemaking, in contract rates, and other matters representatives of the grain shipping industry might propose here today. I ask that you consider all of the information that is now available on the effects which deregulation has had upon the grain industry, and attempt once again to balance the interest of the rail carriers, the large and the small shippers, the grain producers, other rail users, and the public, and to develop any amendments to the statutes that may be necessary to achieve that balance.

In addition to this broad challenge to the subcommittee, I have two specific suggestions to offer. The first concerns the issue of contract rate disclosure. At a minimum, Congress should establish appropriate requirements for more extensive disclosure of contract rate information. The current requirements that proof of discrimination must be shown before disclosure can be mandated is unworkable. Neither the shippers nor the State public service commissions and departments of transportation have adequate opportunity for review. Moreover, an adjustment in the disclosure requirements would enable the Interstate Commerce Commission to more fully carry out its responsibilities, and more important, would arm Congress with the information necessary to consider what additional action might be required.

In addition, Congress should take another look at those aspects of deregulation which effectively have preempted all state regulation of rail transportation, including intrastate traffic. The Kansas Corporation Commission has been provisionally certified to regulate intrastate rail rates in Kansas, and its application for permanent certification is pending with the Interstate Commerce Commission. To date, only one State has been permanently certified. However, even when certification is granted, the States are left with virtually no discretion in determining intrastate rates. Recent decisions of the ICC on exemptions and contracts have further limited the authority of States under the Staggers Act. States should be granted some flexibility in dealing with localized problems such as the grain situation in Kansas. In a time when responsibility is being turned back to the states in a number of areas, the role of the states in regulating rail transportation under the Staggers Act should be reexamined.

Finally, I point out that I have actively supported the coal transportation policy statement recently adopted by the National Governors' Association. The Governors have urged the Interstate Commerce Commission and the Congress to take a new look at the Staggers Act as it affects coal transportation, to ensure that the interests of carriers, shippers, and the public are balanced. Our concerns in the area of coal transportation are different from our concerns regarding grain transportation, but the need for review in each area is clear. I appreciate the subcommittee's efforts to include the grain industry in the current review of the Staggers Act, and I thank Senator Kassebaum in particular for her role in providing this forum for Kansas involved in the grain industry to comment upon how the Staggers Act has affected them.

Senator **Kassebaum**. Thank you, Governor Carlin. Congressman Glickman.

Mr. **Glickman**. Thank you, Senator, and I appreciate the chance to be here this morning very much. As simple as it may seem, moving grain from the field to processor and then food to the table is probably one of the most complex undertakings of our economy. That it appears so simple most of the time is testament to the efficiency of the system. In spite of the fact that it works so well or perhaps because it does indeed work so well the majority of the time, we in Kansas know that the system is not flawless. Some problems and frictions between different players are still very much with us. Some new problems have arisen in the last couple of years and that Congress needs to continue its vigilance.

At the time the House considered the 1980 Staggers Rail Act, many of us had serious reservations about the ramifications of moving quickly from a rigid historic tradition of regulation to the relative freedom of the deregulation of the Act. Indeed, at the same time we studied one of the main features of the bill, to permit greater ease for line abandonments, Kansas shippers and farmers were thrown into havoc by the discontinuation of service along the Rock Island line. I might note parenthetically the enormous effort of yourself in restoring some of the service along this line.

In addition to this one very major episode, several concerns have come to my attention over the last couple of years I want to make sure the committee considers in its deliberations. First of all, Kansas has traditionally had problems at harvest time coordinating the need for hopper cars with supply. The shortage of cars which has plagues us over in the past, according to a GAO study I requested 3 years ago, is a result of faulty coordination and flow of information within the market and not so much a shortage of physical cars. While we have been fortunate in the last couple of years not to experience the problem in the same severity as we have seen in the past, I think the gradual loosening of Federal, and that's ICC, oversight of the industry and thus the ability of Government to step in and promote remedial actions ought to be studied. This topic is one area, for example, that increased help from related agencies, such as the Agriculture Department's Office of Transportation and Crop and Livestock Reporting Service which provides forecasts of harvest conditions and thus gives some idea of car demand in specific locales, may be beneficial and ought to be better coordinated and related to the private sector.

While some observers of the industry believe that deregulation has not caused the problems many of us feared, I think the jury is still out. While considerable evidence exists of very competitive rate offerings for many shippers, I think many witnesses here today, and I know that I and Governor Carlin and yourself have heard this complaint often, fear being at the mercy of one line as a captive shipper or fearing the loss altogether of rail service as I noted earlier. Besides that, I know that some in the industry believe that railroads have been most competitive in this time of slack demand in places with largest volumes of potential volume, the terminal elevators, without really passing on the benefits of rate flexibility to smaller shippers, and these same shippers are concerned that this problem may only get worse as traffic increases along with economic recovery.

We have seen over recent months another trend which needs to be watched as the economy fluctuates. In past years railroads have encouraged the development of private fleets of cars, but as traffic slackened with recession, the lines began charging premiums for moving these cars. While the railroad's position can be understood, I think those of us on the outside seeking an equitable system must see what we can do to help iron out the boom and bust cycles which give rise to this particular problem, and this may be one of these instances where better Government-private sector cooperation and communication can alleviate some problems.

While line abandonments and service problems have forced many traditional rail users to trucking at generally much higher costs and with the problems the Governor pointed out to the State, another wrinkle has also come to my attention, the matter of switching rates. While through rates may be trending downward and put a veneer of competitiveness on the industry at present, a significant charge for switching cars, especially if it falls hardest on small and captive shippers, belies some fundamental distortions regulators and Congress needs to study.

Let me close by saying that I still have some reservations about deregulation, not the concept, which most favor, but the way it has and will work out in an industry steeped in the tradition and practices of very strict Federal control. Whereas deregulation has and will work out very well in many areas for the consumer in which he or she has the greatest freedom of choice, the logistics of the rail industry are much different from, say, airlines or banks and as such need continued Government supervision to insure equity in rates and service.

I would close by making one point that I think that was referred to in the Governor's statement. I chaired an ad hoc Subcommittee on Grain Elevator Bankruptcy, and it appears to me that many small elevators in this country which have had serious financial problems during the past 4 or 5 years will be jeopardized by some of the problems associated with rapid fluctuation of rail rates and with the issue of line abandonments and the insecurity of not knowing whether those lines will stay open. I would urge the subcommittee to consider that issue, the issue of the viability of the small grain elevator in connection with other aspects that you're hearing. I appreciate the fact that you have asked me to testify, and I look forward to working with you in the future on this.

Senator **Kassebaum**. Thank you very much. I appreciate the testimony of Governor Carlin, Congressman Glickman. I know that both of you have other commitments and would be happy to have you stay, but certainly realize the pressure of time. Thank you very much.

It is a great pleasure to welcome the Chairman of the Interstate Commerce Commission, Reese Taylor, and his assistants. I must say the Chairman interrupted a vacation in a cooler area of the country to come to Kansas. I am sure everyone would feel if you brought rain, Chairman Taylor, that it would be the best thing you could do to come participate in the hearing this morning. I think his comments and his willingness to participate in the debate and the discussion following his opening statement will be very worthwhile. Welcome, and would you please introduce those others.

STATEMENT OF HON. REESE H. TAYLOR, JR., CHAIRMAN, INTERSTATE COMMERCE COMMISSION

Mr. TAYLOR. Senator, we are delighted to be here, we really are, and we had thought we were going to bring some rain. We had heard the weather reports indicated there might be some rain in St. Louis.

Senator KASSEBAUM. Well, it is cooler, a little bit.

Mr. TAYLOR. A little cooler. Let me start off by introducing those at the table with me this morning. On my left is Gail Gibbons, who is one of my attorney advisors, and on my right is Jan Rosenak, the Commission's Legislative Counsel.

I want to thank you for this opportunity to appear here today to present the views of the Commission concerning implementation and effects of the Staggers Rail Act of 1980, and I would like to pay particular attention to the effects of the act on grain transportation.

It is a pleasure to visit this part of the country and to hear firsthand the views of the other witnesses this morning. As a matter of fact, I think we will learn a lot more by listening than talking, and that is one of the reasons we are going to try and stay. I might say at this point I do have to leave around noon, but Gail and Jan have agreed to stay on into the afternoon, perhaps even after the hearing is closed, to meet with any of the people who are here who have some questions or could impart some information to us that would be of value.

I have submitted a written statement for the record and I would like to summarize that statement for you at this time.

Given the Staggers Act's overall mandate, the Commission has conducted numerous proceedings, many of which were specifically required by the statute. In our view, the Staggers Act and our implementation of it have been generally successful in removing unnecessary regulation, encouraging efficient carriers to earn adequate earnings and balancing interests of the parties in accordance with the goals of the act. The ultimate result, we believe, will be a more healthy, competitive rail industry with benefits accruing to all concerned.

Turning to matters of particular concern to grain shippers, I would like to summarize some of the Commission's decisions implementing the Staggers Act. The contract provision, section 208 of the act, was implemented in a decision served in November of 1982 in Ex Parte No. 387, Railroad Transportation Contracts. We have attempted to devise workable rules that will encourage the filing of contracts without impairing the rights of protestants or unfairly injuring contracting parties by disclosing proprietary information.

The contract rules were appealed and oral argument has been held before the U.S. Court of Appeals for the Second Circuit in New York. One of the key provisions before the court in that proceeding is whether the Commission rationally determined the degree to which terms of rail rate contracts could be subject to mandatory tariff disclosure, particularly with regard to agricultural shippers.

As we pointed out in our decision, the task confronting the Commission in that case required a balancing of competing interests, a recognition of the private nature of contractual agreements on the one hand and on the other, release of essential terms to the public so that possible complaints may be filed. Based on the legislative history, as well as the specific language of the provision, the Commission attempted to strike what it believed to be an appropriate balance. Of course, as confirmed by the concurring and dissenting opinions filed by some members of the Commission, myself included, any two persons might not be in total agreement as to precisely where the line should be drawn.

It is my opinion, and I want to assert this very strongly, as pointed out in my separate expression in Ex Parte No. 387, that the applicable rates and charges, including rates and charges for special features, are absolutely essential terms which must be fully disclosed in the contract summary. In my view, without such information, the protection provided in the statute for shippers of agricultural commodities, forest products and paper will be totally meaningless. A decision by the court in this matter is expected soon.

I might just pause at this moment to quickly read a couple of little provisions from my separate expression because I did feel very, very strongly about this and strongly enough to say so. I indicated that I departed from the majority's approval of the regulations adopted on the question of disclosure of full rather than base rates and charges in the contract summary. While Congress intended to encourage agricultural, forest products and paper shippers to contract, it recognized the difficulties such shippers might have in negotiations. The Commission was thus granted the power to find that a contract is unreasonably discriminatory or constitutes a destructive competitive practice. Congressional concerns for small businesses and the granting of powers to the Commission to find unreasonable discrimination or destructive competitive practices for shippers of agricultural commodities, forest products and paper will be totally meaningless if all the applicable rates and charges are not set out in the contract summary. These are essential terms as the statute calls for. Knowledge of only the base rates and charges as defined in this decision does not tell a shipper what it needs to know. Without this itemization a complainant cannot determine whether a necessary factor for unreasonable discrimination in rate disparities exists or whether there are specific grounds to assert that the contract constitutes a destructive competitive practice.

To further illustrate the use of contracts, the Commission recently amended its rules to permit rail contracts to be implemented prior to Commission approval. We found that our previous policy requiring a 30-day public notice before transportation under a contract may begin is not mandated by the act. However, I will emphasize that any party's right to challenge contracts remains intact, that is important to remember, since the Commission retains jurisdiction over these contracts during the period prior to formal approval or disapproval. Thus the change in rules simply allows the contracting parties to begin operations in a timely manner and to better compete, frankly, with trucking. The Commission retains the right to disapprove the contract, in which case the contract or tariff rates previously in effect will be fully applicable.

Also, I should mention that the contract provision has been extensively used. As of mid-August more than 9,000 contracts had been filed with the Commission since the effective date of the act. On a commodity basis, contracts involving grain or grain products comprise about 13 percent of the total. If you add them with forest products and paper, it is about a third.

Another important decision implementing the Staggers Act was Ex Parte No. 320, Market Dominance Determinations and Considerations of Market Competition. Accurate market dominance determinations are central to fulfilling the goals of the Staggers Act, namely, that competition and demand for services are to be the determining factors in railroad ratemaking except where there is an absence of effective competition.

Our decision in this proceeding eliminates the prior rebuttable presumptions of market dominance based on cost, market share and substantial investment. The presumptions have been replaced with general guidelines. Because of the wide variation in circumstances from case to case, we believe the flexible approach we have adopted will provide a more useful and reliable method of determining the railroads' market power in a given situation.

In another proceeding the National Industrial Transportation League sought institution of rulemaking for the purpose of issuing rules, first, to prohibit anticompetitive railroad cancellations of joint and through routes, reciprocal switching, and the closing of gateways, and, two, to implement the procompetitive provisions of the Staggers Act pertaining to reciprocal switching arrangements and the joint use of terminal facilities, through trackage rights or otherwise.

In a decision denying the petition, the Commission concluded that rulemaking would be administratively impractical because the specific facts in each case require individual analysis and adjudication.

Again in a separate expression, I pointed out that Congress intended to balance the Staggers Act goals of competition and adequate revenue levels with the maintenance of an efficient, coordinated national rail system. A public proceeding in my view would have explored those goals and the tools available to the Commission to strike that balance and would also have assisted in the Commission's adjudication of subsequent proceedings.

The Commission has, however, initiated a study in lieu of this public argument and hearing, a study of the joint rate cancellation issue, and that is in progress now, and we will endeavor to determine from the study whether further action is necessary. Comments in conjunction with the study may be requested at a later date. Petitions for reconsideration of the Commission's decision have been filed and they are presently pending.

Another recent decision in Ex Parte No. 347, Sub. 1, Coal Rate Guidelines—Nationwide, is perhaps important to discuss just for a moment. In that proceeding, the Commission proposed a maximum rail rate policy applicable to captive coal traffic. You might say why is that important in Kansas? Under the proposed constrained market pricing approach, rail carriers' pricing of market dominant coal traffic would be subject to four upward constraints. First, a coal shipper could not be charged more than the stand-alone cost of serving its traffic. Second, captive shippers would not be required to bear the cost of pricing inefficiencies. This constraint also incorporates the statutory standard of honest, economical and efficient management of the so-called Long-Cannon factors. Third, carriers would generally not be permitted to increase their rates on captive traffic by more than 15 percent in a single year after inflation. Fourth, until a rail carrier achieves revenue adequacy, it would be free to adjust its rates on captive coal traffic unless it violates one of the three other constraints. I should emphasize that if the rate on market dominant coal traffic violates any one of the constraints, it could be found unreasonable. Each factor acts as an independent restraint, and all four must be looked at together as working in conjunction with each other in order to form a kind of matrix of constraints.

Comments in this proceeding were filed in late July and are presently being carefully reviewed by the Commission. Questions have arisen recently with regard to the application of the proposed coal rate guidelines to other commodities, and that is why I am mentioning it here in Kansas. In early June, we denied a request to expand the scope of the proceeding to other commodities because we felt it would be unwieldy and unnecessary. We stated that noncoal shippers need not participate in this proceeding in order to protect their interests. To the extent we may consider applying the maximum rate policy developed in this proceeding to commodities other than coal, affected parties will be afforded ample opportunity to address the propriety of that action in the proceeding that is involved. In fact, in a series of recently reopened proceedings, the Commission has specifically sought comments on whether and to what extent the proposed coal rate standards should be applied to the commodities involved.

Another important Staggers Act change involves the expansion of the Commission's exemption authority. Since passage of the Staggers Act, the Commission has modified and streamlined its exemption procedures. Recently, the Commission approved exemptions for boxcar and export coal movements. The former generally excludes from rate regulation the rail transportation of commodities moving via boxcar. The decision also authorizes the railroads to impose charges for the storage and return of empty boxcars and, at their option, to negotiate bilateral car hire agreements to apply in lieu of car hire rates prescribed by the Commission.

The export coal decision scheduled to become effective September 12, 1983, will exempt all aspects of export coal transportation from regulation. These two decisions, and I must say my very, very strong dissenting views, are discussed in the appendix to my prepared statement.

Finally, I should mention a subject I know is of concern and which has already been briefly mentioned to many of you who are here today, private car use and compensation. Over the years, there has been a shortage of covered hopper cars with the result that shippers have in many instances felt compelled to purchase their own cars. While this augmentation of the fleet has worked well in peak shipping periods, many of these cars are idle during times of decreased demand. This situation has resulted in the filing of a complaint by a shippers' group alleging that the required utilization of carrier equipment rather than private cars in periods of slack demand is unlawful.

In conclusion, as we testified at the Senate and House oversight hearings in July, effective competition is the key to the success of the Staggers Act and its implementation. An environment where efficiency, flexibility and adequate revenues are encouraged will promote such competition and related benefits. I hope that the Commission is implementing the act with this in mind. That completes my testimony, and now I would be pleased, Senator, to respond to any questions that you might have.

Senator **Kassebaum**. Thank you very much for the very thorough analysis of the Staggers Act, particularly of course as it applies to the transportation of grain.

As you know and have heard even in the Washington hearings, the contract provision is one that has caused a great deal of concern and belief that it leads to discriminatory practices. Do you feel that this is so? You obviously believe that any party's right to challenge does enable one to have access. On the other hand, if there is not a full disclosure of contracts, does it not make it difficult to know if there is a case to be made?

Mr. **Taylor**. Well, I think you are absolutely correct, Senator. I know that you had an important hand in the drafting of this language. I did not have as much problem with it as I guess some others have because the contention has been made that maintaining the confidentiality which is provided for in the statute, on the one hand, and revealing the essential terms on the other, create some sort of a conflict. To me you have to have a full disclosure of the rates. If there is an essential term in a contract, it has to be what the rates are. I know that because agricultural shippers, including forest products and paper shippers, were specifically singled out and provided the right to complain about certain matters that nonagricultural shippers or nonforest product shippers cannot complain about, the latter are essentially limited to the common carrier obligation. Since the matters about which agricultural shippers can complain, discrimination and destructive competitive practices as set forth in the statute, are supposed to be there for them to have resort to, I submit, as indicated in our separate expression, that if they do not have a full disclosure of the rates, the rest of it really becomes totally meaningless.

Now, I think we may be going in the right direction on this in terms of what is going on with the court case, because I understand after discussing the matter with our General Counsel's Office, a day or two ago that in the argument that ensued in May, the one thing the court really jumped on was the very point that I had raised in my separate expression. And that was that this base rate disclosure was really not sufficient to afford agricultural shippers an appropriate remedy under the statute. So we may get some judicial relief on that point, but I would certainly agree with you that if the disclosure is not there, then the protections that were intended really are rendered rather meaningless.

Senator **Kassebaum**. I will have some further question of the producers when they testify later as far as their own interpretation of even with full disclosure, is this going to be beneficial to them in bringing a case, but I would like to ask as far as the ICC's authority, do you believe that—it used to be 30 days after filing, is that not right? Now it ends immediately upon filing. Is that correct?

Mr. **Taylor**. Are you talking now about a railroad putting a rate into effect?

Senator **Kassebaum**. Right.

Mr. **Taylor**. We took away the 30-day notice requirement essentially to allow the railroads to compete better with trucking. Most agricultural commodities, for example, are exempt for truckers and they of course have been engaged in a free-for-all insofar as rates are concerned, as we all know. I think the railroads felt that, in order to adequately compete, because they have lost market share in an awful lot of areas, that it was important to be able to allow them to effectuate their rates quickly. The important point is that that doesn't take away anybody's rights to complain about the contract. It is just a question of how fast it can go into effect.

Senator **Kassebaum**. But will you lose your authority over it once it is filed?

Mr. **Taylor**. No.

Senator **Kassebaum**. Approved?

Mr. **Taylor**. Once it is approved we lose our authority, but the approval does not get washed aside simply because we allow it to go into effect early. We have an early effective time and then we review it. As indicated in my testimony, if the approval is not granted, then the prior rates go into effect.

Senator **Kassebaum**. But you see that as——

Mr. **Taylor**. We think that that facilitates competition and that the 30-day wait really was not necessary. As long as the shippers still have the right to complain and we still have the power to do something about it prior to approval, we do not think anybody's rights are jeopardized, and we think the railroad is better postured to compete.

Senator **Kassebaum**. Regarding the joint rates, when do you anticipate the study will be completed?

Mr. **Taylor**. Well, they are working on it now. It is very difficult for me to give you a specific deadline. I would hope that we are going to have some results back within the next few months. I really had felt that we should have had a full-fledged proceeding on that and wanted very much to do so. There may be another opportunity for us to do so in that the Chemical Manufacturers' Association has a complaint, and I may simply hold an oral argument on that matter in order to give everybody an opportunity to come forward and talk about it. I think that is terribly important.

A number of shippers have indicated that some of their competitive alternatives are simply disappearing, and certainly I know it was not Congress intent for the enactment of Staggers to in any way constrict competition. The idea was to enhance competition and let it be the regulator instead of the Commission wherever it could come into play. To remove competitive alternatives, I think raises a very serious threat and the matter should be very carefully and thoroughly explored. I would have liked to have seen our study be a supplement to a full-blown proceeding. We may yet have an opportunity for some oral argument on the chemical complaint that is before us.

Senator **Kassebaum**. I would like to suggest that at this point, rather than my continuing to ask questions that if you would join me, and Ms. Rosenak and Miss Gibbons as well, as we will continue the hearing and then those who are testifying I am sure will have many questions that they would like to ask of you as well, and I think that would help facilitate.

Mr. **Taylor**. Let me just throw out if I might, Senator, one suggestion because I think there is a possibility that there might be some legislative relief for this contract section that would materially help. We have given it a great deal of thought, and it seems to me that if you look at this proposition sort of like people bidding on a contract. Of course, they all want all kinds of secrecy up front; I think you all want that. You do not want your bidders sitting down around this burning candle and deciding whether they are going to put their bids together. But, after it is done, you have an opening, and everybody sees what everybody else bid. And that prepares them to do something for the next occasion. It seems to me maybe you could do that with these rail contracts. Congress could specify that after a 30-day period or a 60-period following execution of the agreement that the agreement simply becomes public. It would really materially improve the whole situation if you simply said so many days after execution—60 days, whatever—the contract becomes public and everybody gets an opportunity to see it. Keep it as secret as you like while it is being negotiated and for some period of time until it is being negotiated and for some period of time until it is set in place and actually in operation. I cannot provide you with any specific language. We have not really thought about where and how the disclosure might come, but I think that is an idea that I would like to throw out because I would be interested frankly in hearing from some of the other people who are here today what they think of that idea.

Senator **Kassebaum**. Particularly the railroads.

Mr. Taylor. Right.

Senator **Kassebaum**. I was going to ask about that, but I thought from your comments that you felt perhaps the court decision might actually—did I misunderstand you?

Mr. **Taylor**. Well, the court decision will affect the matter of whether or not a base rate disclosure vis-a-vis actually setting forth the rates themselves in the summary constitutes appropriate disclosure under the statute as it is presently written.

Senator **Kassebaum**. So we would still need further statutory language to——

Mr. **Taylor**. Well, I just have a feeling that maybe it might not be a bad idea to at least explore the possibility, instead of trying to do this balancing act between not revealing confidential information on the one hand and on the other this essential terms proposition which to me certainly should include all of the rates. I think that struggle is going to continue to insure even if we get this particular point clarified. It might just eliminate the entire overall problem if Congress were to say in lieu of what we have now, how about just indicating that after a 60-day period, we will say, following a contract's execution, it becomes public for all to see. I would be very interested in hearing, as you suggest, what the railroads have to say about that and why, if there are some reasons that that should not be done, what they are, and whether or not the shippers would feel that that would be helpful.

Senator KASSEBAUM. Thank you very much.

Mr. TAYLOR. Thank you.

[The statement follows:]

STATEMENT OF HON. REESE H. TAYLOR, JR., CHAIRMAN, INTERSTATE COMMERCE COMMISSION

Chairman Kassebaum, I want to thank you for this opportunity to present the views of the Commission concerning the implementation and effects of the Staggers Rail Act of 1980 with a special emphasis on the effects on grain transportation. It is a pleasure to visit this part of the country, and to hear firsthand the views of the other witnesses this morning.

The Staggers Act represented the second major effort in 5 years to resolve the continuing problem of railroad revenue adequacy.[1] This legislation has substantially reduced Federal regulation of the rail industry, while providing rail carriers with the opportunity to obtain adequate earnings. The act was intended to assist the rail system to remain viable in the private sector of the economy and to allow the railroads to compete more effectively among themselves and with other modes of transportation.[2] To assist in the revitalization and modernization of the rail system, the Staggers Act encourages competition, provides for the prompt recovery of costs, promotes greater rate and service flexibility without government interference, and emphasizes the need for adequate rail revenues. While there is greater reliance on the forces of the marketplace, a regulatory process remains to balance the needs of carriers, shippers, and the public where warranted, such as in the absence of effective competition.

Given the act's overall mandate, the Commission conducted numerous proceedings, many of which were required specifically by the statute. In our view, the Staggers Act and our implementation of it have been generally successful in removing unnecessary regulation, encouraging efficient carriers to earn adequate earnings, and balancing the interests of the parties in accordance with the goals of the act. The ultimate result, we believe, will be a more healthy, competitive rail industry with benefits accruing to all concerned.

Turning now to matters of particular concern to gain shippers, I would like to summarize some of the Commission's decisions implementing the Staggers Act. The contract provision, section 208 of the act (49 U.S.C. § 10713), was implemented in a decision served November 4, 1982, in Ex Parte No. 387, *Railroad Transportation Contracts.* We have attempted to devise workable rules that will encourage the filing of contracts, without imparing the rights of protestants or unfairly injuring contracting parties by disclosing proprietary information.

The Ex Parte No. 387 rules were appealed, and oral argument has been held before the U.S. Court of Appeals for the Second Circuit. One of the key issues before the court in that proceeding, as framed in the parties' briefs, is whether the Commission "rationally determined the degree to which terms of rail rate contracts would be subject to mandatory tariff disclosure, particularly with regard to agricultural shippers.[3]

As pointed out in the Commission's decision, the task confronting the Commission in that case required a balancing of competing interests—a recognition of the private nature of contractual agreements, on the one hand, and, on the other hand, release of essential terms to the public so that possible complaints may be filed on the limited grounds available. Based on the legislative history, as well as the specific language of the provision, the Commission believes that its rules struck an appropriate balance. Of course, as confirmed by the concurring and dessenting opinions filed by some members of the Commission, myself included, any two persons might not be in total agreement as to precisely where the line should be drawn. A decision by the court in this matter is expected soon.

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[1] The first was the Railroad Revitalization and Regulatory Reform Act of 1976 (the 4R Act).

[2] The goals of the act, as set forth in section 3, are as follows: (1) to assist the railroads of the Nation in rehabilitating the rail system in order to meet the demands of interstate commerce and the national defense; (2) to reform Federal regulatory policy so as to preserve a safe, adequate, economical, efficient, and financially stable rail system; (3) to assist the rail system to remain viable in the private sector of the economy; (4) to provide a regulatory process that balances the needs of carriers, shippers, and the public; and (5) to assist the rehabilitation and financing of the rail system.

[3] See Joint Brief of the Interstate Commerce Commission and the United States of America, page 1 [*Water Transportation Association et al.* v. *ICC,* No. 82-4182 (2d Cir.)].

To further facilitate the use of contracts, and also to eliminate short-notice exemption requires (over 900 requests of this nature were filed and granted in the last 2 years), the Commission recently amended its rules to permit rail contracts to be implemented prior to Commission approval. [Ex parte No. 387 (Sub-No. 200), decision served May 26, 1983]. We found that our previous policy (30-day public notice before transportation under a contract may begin) is not required by the act. However, I would emphasize that any party's right to challenge contracts remains intact, since the Commission retains jurisdiction over these contracts during the period prior to formal approval or disapproval. Thus, the change in rules simply allows the contracting parties to begin operations in a timely manner. The Commission retains the right to disapprove the contract, in which case the contract or tariff rate previously in effect will be fully applicable.

Also, I should mention that the contract provision has been extensively used. As of mid-August 1983, more than 9,000 contracts had been filed with the Commission since the effective date of the act. On a commodity basis, contracts involving grain or grain products comprise slightly more than 13 percent of the total.

Another important decision implementing the Staggers Act was Ex Parte No. 320 (Sub-No. 2), *Market Dominance Determinations and Considerations of Product Competition,* served July 8, 1981. Accurate market dominance determinations are central to fulfilling the goals of the Staggers Act, namely, that competition and demand for services are to be the determining factors in railroad ratemaking except where there is an absence of effective competition.

Our decision reflects the provisions of the Staggers Act and our experience to date with the market dominance rules established pursuant to the 4R Act. Basically, the proceeding had two purposes: (1) the reexamination of existing market dominance regulations; and (2) a determination, as mandated by section 205 of the Staggers Act, whether and to what extent "product competition" should be considered in determining the reasonableness of rates.

Our decision in this proceeding eliminates the prior rebuttable presumptions of market dominance based on cost, market share, and substantial investment. The presumptions have been replaced with general guidelines. Because of the wide variation in circumstances from case to case, we believe the flexible approach we have adopted will provide a more useful and reliable method for determining the railroads' market power in a given situation.

With regard to product and geographic competition, we concluded that these factors, which have little, if any, bearing on costs, should not be considered in our reasonableness determinations, since such determinations are based primarily on a comparison of the challenged rate and the cost of the movement to which it applies. However, these two factors (which are traditional factors assessed to determine competition in antitrust litigation) are evidence of the existence of competition that can serve as effective constraints on the abuse of market power by rail carriers. Thus, in our view, product and geographic competition are relevant in determining whether a carrier is market dominant vis-a-vis particular traffic.[4]

In *Western Coal Traffic League* v. *United States,* 694 F.2d 378 (5th Cir. 1982), the court in a 2-to-1 decision held that the Commission is prohibited from considering evidence of product or geographic competition in making a determination of market dominance. A rehearing en banc was granted, and the case was orally argued on June 6, 1983. Accordingly, our current guidelines regarding product and geographic competition are still in effect. A decision by the court is expected in the next several months.

In Ex Parte No. 445, *Standards for Intramodal Rail Competition,* the National Industrial Transportation League [NITL] sought institution of a rulemaking for the purpose of issuing rules to: (1) prohibit anticompetitive railroad cancellations of joint rates and through routes, reciprocal switching, and the closing of gateways; and (2) implement the pro-competitive provisions of the Staggers Rail Act of 1980 pertaining to reciprocal switching arrangements, and to joint use of terminal facilities, through trackage rights or otherwise.

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[4] Under our prior regulations, product and market competition were not considered germane in computing market share, but such evidence could be introduced to show that effective competition existed.

In its decision denying the petition, the Commission concluded that rulemaking would be administratively impractical because the specific facts in each case require individual analysis and adjudication. It emphasized that each carrier should be allowed all possible freedom to structure its own pricing, service and other competitive responses, and that the Commission should intervene only where there are inadequate economic restraints on market power. With regard to recent cancellations and other restrictive carrier actions, the Commission has undertaken a study of the changes that are occurring, their reasons and effects, and will determine from the study whether further action is necessary. Comments, in conjunction with the study, may be requested at a later date.[5] Petitions for reconsideration of the Commission's decision in Ex Parte No. 445 have been filed and are presently pending.

Reciprocal switching issues are being handled on a case-by-case basis. Under section 11103, the Commission may require rail carriers to enter into reciprocal switching agreements when it finds that such agreements are practicable and in the public interest, or where such agreements are necessary to provide competitive rail service.

Also, in this regard, as reported in our Joint Rates Study, which was submitted to Congress on November 12, 1982, it appears that joint rate cancellations are becoming the major tool used by carriers to achieve joint rate relief. For fiscal year 1982 and for the first half of fiscal year 1983, cancellations protested before the Commission totaled 24 and 15, respectively. While these numbers appear relatively small, many of the cancellations have broad application. Our experience indicates that most parties have been able to adjust adequately to cancellations affecting them. Nevertheless, we are aware of substantial concern expressed over certain cencellations. As a result of this concern and our own interest in monitoring how cancellations have begun altering the joint-care structure, the Commission, as I mentioned, has initiated a study of the joint rate cancellation issue.

Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines—Nationwide,* is another important recent decision. In that proceeding, by decision served February 24, 1983, the Commission proposed a maximum rail rate policy applicable to captive coal traffic.[6] Under the proposed "constrained market pricing" approach, rail carriers' pricing of market dominant coal traffic would be subject to four constraints. First, a coal shipper could not be charged more than the "stand-alone cost" of serving its traffic. Second, captive shippers would not be required to bear the cost of pricing inefficienecies. This constraint also incorporates the statutory standard of "honest, economical and efficient management." Third, carriers would generally not be permitted to increase their rates on captive traffic by more than 15 percent in a single year (after inflation). Fourth, until a rail carrier achieves revenue adequacy, it would be free to adjust its rates on captive coal traffic unless it violates one of the three other constraints. I should emphasize that, if the rate on market dominant coal traffic violates any one of the constraints, it could be found unreasonable—each factor acts as an independent restraint.

This proposal represents the culmination of the Commission's efforts to arrive at a formula for prescribing maximum reasonable coal rates. To achieve the revenue adequacy goals of the Staggers Act, railroads should be able to assess rates high enough to recover on a system-wide basis all variable costs and constant costs, including a return on investment equal to the current cost of capital. The difficulty lies in the fact that not all rail movements can be priced at this level, mainly due to varying forms of competition. This contrasts, for example, with electric utility ratemaking, a situation in which the users generally have virtually no other option. Accordingly, to reach revenue adequacy, railroads have to price some movements differentially (in other words, allocate constant costs disproportionately).

Comments in this proceeding were filed in late July and are presently being carefully reviewed by the Commission.

Last February, at the same time our decision was served in Ex Parte No. 347 (Sub–No. 1), we issued a Notice of Intent to Prepare an Envirnomental Impact Statement and Statement of Energy Impact and Proposed Scope in the proceeding. The notice set forth specific questions concerning the energy and environmental effects of setting maximum rail rates for captive coal traffic. On April 28, 1983, various utility coal shippers filed joint comments on the notice and on environmental issues. These parties also requested commencement of a rulemaking proceeding for "the institution of mandatory trackage rights to shippers as an alternative to stand-alone costs, should they be implemented."

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[5] In a separate expression (concurring in part, dissenting in part), Chairman Taylor noted that Congress intended to balance the Staggers Act goals of competition and adequate revenue levels with the maintenance of an efficient, coordinated national rail system. A public proceeding would explore those goals and the tools available to the Commission to strike that balance, and would also assist the Commission's adjudication of subsequent proceedings. In his view, a staff study should supplement, not substitute for, a thorough examination of the highly important policy issues raised by NITL.

[6] Vice Chairman Sterrett and Commissioner Andre dissented.

By decision served July 20, 1983, we denied the request for rulemaking because of the lack of a statutory basis for exercising jurisdiction over trackage rights matters, absent agreement between rail carriers. Generally, we have no power under the statute (49 U.S.C. § 11343) to compel a railroad to grant trackage rigthts over its lines. Even in consolidation proceedings, where the Commission can impose trackage rights as a condition to consolidation, agreement must be reached between the carriers. Thus, the shippers' proposal failed to meet the statutory criteria for exercise of Commission authority in this area, namely (1) that there be an agreement between the parties; and (2) that the parties be rail carriers.

The decision indicated that petitioners' additional contentions concerning consideratin of forced trackage rights and the quantification of the difference between costs established in the basis of trackage rights plus shipper acquisition of equipment and crews, on the one hand, and stand alone costs as proposed by the Commission, on the other, will be considered in the environmental assessment and the final decision in Ex Parte No. 347 (Sub-No. 1), respectively.

Questions have recently arisen with regard to the application of the proposed coal rate guidelines to other commodities. On June 2, 1983, we denied a request to expand the scope of Ex Parte No. 347 (Sub-No. 1) to other commodities because it would be unwieldy (considering its status, background and voluminous record) and unnecessary. We stated that "Non-coal shippers need not participate in this proceeding in order to protect their interests. To the extent we may consider applying the maximum rate policy developed in this proceeding to commodities other than coal, affected parties will be afforded ample opportunity to address the propriety of such action in the proceeding involved." In fact, in a series of reopened proceedings (No. 37809, et al.), served June 2, 1983, the Commission specifically sought comments on whether and to what extent the proposed coal rate standards should be applied to the commodities involved.

Another important Staggers Act change involves the expansion of the Commission's exemption authority under 49 U.S.C. § 10505. The Commission is required to use its exemption authority when the Commission finds that regulation is unnecessary to effectuate the rail transportation policy of section 10101a; and either (1) the transaction or service is of limited scope; or (2) regulation is not necessary to protect shippers from the abuse of market power.

Since passage of the Staggers Act, the Commission has modified and streamlined its exemption procedures. We have finalized the exemption of most railroad TOFC/COFC traffic. The TOFC/COFC exemption, which has been affirmed in all significant respects by the Court of Appeals for the Fifth Circuit, has proved very beneficial, as has the earlier exemption of fresh fruits and vegetables. According to reports we have received, many rates on fruits and vegetables and TOFC/COFC are lower, and service has substantially improved since the Commission approved these exemptions. We expect similar results from our decision to exempt agricultural commodities (except grain, soybeans, and sunflower seeds), liquid iron chloride, iron sulphate, and hops. Exemptions for frozen foods, storage, and surplus cares, poultry, meat, and dairy products, and a group of manufactured commodities are now under study.

The Commission has actively employed its rail exemption authority to reduce further unnecessary regulation in other areas as well. In the finance area, we have granted hundreds of exemptions for individual rail transactions where the transportation or public impact was minimal, or our regulation was not needed to protect shippers from an abuse of market power.

Recently, the Commission approved two other exemptions for boxcar and export coal movements. The former excludes from rate regulation the rail transportation of all commodities moving via boxcar except nonferrous recyclables. The decision also authorizes the railroads to impose charges for storage and return of empty boxcars and, at their option, to negotiate bilateral car hire agreements to apply in lieu of car hire rates prescribed by the Commission.

The export coal decision is scheduled to become effective September 12, 1983, and will exempt all aspects of export coal transportation from regulation.[7] These decisions and my dissenting views are discussed in more detail in the attached appendix to this statement.

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[7] At present, the exemption applies to export coal from American ports. Requested comments have now been filed and are under consideration with regard to the applicability of the exemption on coal transported to Canada and Mexico.

Finally, I should mention a subject I know is of concern to many of you—private car use and compensation. Over the years, there has often been a shortage of covered hopper cars, with the result that shippers have in many instances felt compelled to purchase their own cars. While this augmentation of the fleet has worked well in peak shipping periods, many of these cars are idle during times of decreased demand. This situation has resulted in the recent filing of a complaint by a shippers' group alleging that the required utilization of carrier equipment rather than private cars in periods of slack demand is unlawful. The complaint is docketed as Docket No. 39169.

In conclusion, as we testified at Senate and House oversight hearings in July, it is our view that the Staggers Act, and its implementation, are meeting the goals enunciated in the rail transportation policy at 49 U.S.C. § 10101a. We have every reason to believe that the act is and will be beneficial both to the rail industry and the public over the long run.

That completes my prepared testimony, and I will be glad to respond to any questions you may have.

APPENDIX

I. Ex Parte No. 346 (Sub-No. 7), *Railroad Exemption-Export Coal*

By decision served June 9, 1983, the Commission [1] exempted rail export coal from regulation, effective September 12, 1983.

Export coal is sold and transported in a very competitive market where most movements are arranged by a small number of transshipper companies (rather than individual mines) which can exercise considerable leverage over the railroads. As evidence of the shippers' bargaining power, the Commission's decision points out that during a recent 5-year period mine mouth prices increased 468 percent, while export rail rates rose only 57 percent. Even after inflation adjustments, coal prices as of December 1981 were more than two and a half times greater than they were in 1969, but export rail rates increased by less than half. Between 1975 and 1981, export coal rates for the eastern carriers increased 82 percent while their overall costs rose 93 percent.

The Commission's regulation of export coal rates has long been almost nonexistent, since the world market for export coal is highly competitive and transportation pricing is restrained by product and geographic competition, as well as by competition from other transportation modes. The Commission believes that the carriers are not about to price themselves out of the market. They have large sunk costs in export coal facilities and equipment, and loss of the traffic would bring as great a hardship to the carriers as it would to the producers.

The Commission also believes it should be kept in mind that the railroads today make up the only economically regulated link in the chain of parties which handle export coal from domestic mine to foreign consumer. Given the relatively equal bargaining power of the involved parties, the Commission sees little merit in continuing to handicap the railroads' bargaining posture for the division of available economic rents from export coal. Market competition and natural forces of supply and demand should establish reasonable and rational rates for this traffic. The Commission, nonetheless, retains the power to revoke the exemption should the exemption not live up to expectations.

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[1] Chairman Taylor dissented in this proceeding, although he has consistently supported the liberal use of the Commission's exemption authority. To the Chairman the key to this proceeding was the fact that world competition is only minimally relevant when there is almost no domestic competition, either intra- or intermodal. Nor did the record show more than minimal product or geographic competition. As the Commission's goal is to support and encourage competition, and as competition requires relatively equal bargaining positions, to remove all regulation in this instance would also remove what leverage shippers now have and lead to an abuse of market power by railroads. Thus, because this exemption removes all ICC regulation, Chairman Taylor foresaw not ony a lessening of competition, but also a distortion of the demand for services, unreasonable costs for captive products, and a serious misallocation of resources. Equally grave, he found, were the projected negative effects the exemption would have on the economic and social well-being, on the national security, and on the foreign policy.

II. Ex Parte No. 346 (Sub-No. 8), *Exemption From Regulation-Boxcar Traffic*

By decision served May 2, 1983, the Commission [2] exempted boxcar movements of all commodities, except non-ferrous recyclables, from rate regulation. The exemption had been proposed by Conrail and was supported by others, including the Departments of Transportation and Justice, and the Federal Trade Commission. The Commission found that the market share data and revenue/variable cost ratios of record clearly indicated that there is intense competition for boxcar traffic between the railroads and the truckers, and that rate regulation is unnecessary to protect shippers from market power abuse. The Commission expects the unregulated pricing of boxcar service to become simpler and more adaptable to changing market conditions, thus enabling the railroads to compete more effectively with the trucking industry.

Another aspect of the boxcar exemption proceeding involved modifications to the way in which compensation is determined for the use of boxcare equipment. The present system for compensation was arrived at several years ago during a period of severe boxcar shortage, and high rental fees were prescribed by the Commission as a regulatory incentive for equipment acquisition. These rental fees were based primarily or equipment costs rather than on supply and demand factors for equipment use. A large surplus of boxcar equipment has developed in recent years, and many owners have found that the greatest compensation can be gained by having others use their equipment. Thus, home road boxcars are now frequently routed off-line as quickly and as far as possible to gain maximum rental without regard to operational effficiencies. This system has resulted in boxcars moving empty roughly 40 percent of the time, with inefficiency costs borne primarily by the carriers located in areas where more traffic is received than is originated.

The Commission believes that the present regulatory scheme for compensation of boxcar use has long since outlived its usefulness. It stimulates unproductive equipment use in periods of overcapacity and provides compensation without regard to the realities of slackened demand. The Commission has therefore adopted a proposal to allow user railroads: (1) to assess charges for empty movements made at the request of the car owner, the AAR, or the Commission (these charges may not exceed 35 cents per mile, which approximates the cost of providing the movements); (2) to store empty cars and reclaim care hire payments at the expiration of a 72-hour grace period after the car is emptied; and (3) to negotiate compensation agreements with the boxcar owners for car hire, empty movements, and storage. Other aspects of regulation, including mandatory interchange, car supply, and car hire and car service, where agreements cannot be reached, are retained by the Commission.

The Commission believes that these revisions will make car compensation more responsive to market forces by restoring supply and demand factors into the compensation equation. They should also greatly reduce the gross inefficiencies in present boxcar operations. However, the Commission intends to closely monitor the implementation of the boxcar proceeding and will not hesitate to provide further revisions should they prove necessary.

Petitions for reconsideration of the decision are presently pending.

Senator KASSEBAUM. The participants in the next panel will be Joe Gregg, chairman of the legislative committee, Kansas City Board of Trade; Mike Gans of Bennington, Kans., producer; Mike Smith representing Cargill Industries.

Welcome. As I started at the beginning of the hearing, if everyone could keep their comments brief, that will give us that much time to have some discussion, and let us start at the far end and move up, if that is all right. Mr. Smith is traffic manager of Cargill Industries, and welcome.

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[2] Chairman Taylor dissented from the decision on the ground that the record fails to support this broad exemption. In his dessent, he emphasized the paucity of evidence in the record and the overwhelming opposition to the proposal by the industry and virtually all the parties of record. Regarding the car hire/service portion of the decision, he expressed concern for the adverse impact this exemption might have on shortline railroads and on future investments in boxcars. Finally, the Chairman concluded that this exemption imposed an unworkable system on an unwilling public and could endanger the nation's rail transportation system. Additionally, the decision imposed new regulations without notice.

STATEMENTS OF MICHAEL J. SMITH, CORPORATE GENERAL TRANSPORTATION MANAGER, CARGILL, INC.; JOSEPH B. GREGG, CHAIRMAN OF THE LEGISLATIVE COMMITTEE, KANSAS CITY BOARD OF TRADE; AND MICHAEL H. GANS, FARMER-PRODUCER

Mr. SMITH. Thank you very much. My name is Michael Smith. I am corporate general transportation manager of Cargill, Inc. I appreciate the opportunity ot be with the subcommittee today to discuss the effects of the Staggers Act of agricultural shippers. I have prepared a lengthy statement for the subcommittee's consideration, but in order to speed today's proceedings and leave more time for questions, I ask the subcommittee to allow me to summarize my remarks and insert the full text of my statement in the hearing record.

Senator KASSEBAUM. Thank you. It will be done.

Mr. SMITH. Cargill is a warehouseman, processor, merchandiser and transporter of agricultural commodities and other bulk commodities, with operations throughout the United States. We share with the other witnesses appearing today a business interest in an efficient, open, accessible national transportation system.

The Staggers Act was an important step in the development of a more efficient market-oriented rail transportation system, but agricultural has unique marketing needs an a privately owned system has unavoidable limits to open competition that requires some continued protections for grain shippers from the potential abuses of market power at the nands of the railroads. The Staggers Act, as currently interpreted, is not providing those guarantees.

What are agrucilture's unique needs? They are visibility and predictability in pricing of transportation and assurance that transportation services that can be performed will be. The reason is simple. Country grain shippers operate in a national market to meet buyers' needs for both nearby and deferred grain deliveries. Grain and transportation must be packaged together in a delivered price. But while there are means for hedging grain price risks in futures markets, there are no ways to hedge unpredictable grain transportation costs. Since grain marketing margins are a fraction of the potential fluctuations in rail rates, failure of public policy here will widen margins and some disadvantaged shippers will fail.

What limits open competition among railroads? Rail rights of way are private and most agricultural shippers are served by only one railroad. An elevator's rail transportation needs are simple. Competition among several railroads at an eventual destination does not alter the fact that the country elevator has only has only one supplier pricing rail transportation serviceds at the end of its grain spout.

In other words, thousands of country elevator operators and shippers are captives and face market dominance. The unique requirements of each of the literally thousands of agricultural shipping locations make it impossible to hedge transportation risks or to create competitive conditions at each shipping point. Active trading of commodities for shipments as much as 1 year forward in a highly competitive interrelated marketplace requires some public action to insure predictability and transparency in rail ratemaking.

We would recommend public action along several fronts: One, a simple, understandable definitions of captive shipper and market dominance; two, a standard basis for computing railroad costs and resassuring rates; three, enforce prohibitions against demand-sensitive ratemaking; four, maintenance of reasonable joint rates and reciprocal switching arrangements; five, nondiscriminatory use of and compensation for private hopper cars; and six, public disclosure of contract rates.

All of these are important and are discussed in more detail in the statement submitted for the record. Let me take a moment here to emphasize one of particular importance, and that is the publicity of contract rates.

The full public disclosure of contract rates for rail transportation of grain is one of the most important steps that can be taken to the benefit of grain shipppers, both in the short term and the long term. The unique nature of the grain marketing system and the unique role of the railroads in the transportation network require rate visibility and predictability, if the agricultural marketing system is to operate efficiently for all participants.

Congress recognized this need for rate visibility when it included a provision in the act requiring public disclosure of essential terms of rail transportation contracts involving agricultural commodities. However, the ICC's rules in this area have fallen short of providing the rate visibility needed to protect the interests of grain shippers.

Contract disclosure is important to all shippers and essential to the success of many smaller shippers. All shippers must be capable of assessing and comparing rate actions to protect against unreasonable discriminatory actions and destructive competitive practices. But also of importance during periods of extreme rate fluctuations, shippers must be able to have prompt, accurate information on ratemaking agreements in order to bring order to their pricing decisions. Price predictability, at least within general parameters, is a keystone to agricultural marketing.

Shippers who deal with railroads on a regular basis will be better able to gauge the prospects of rate actions than those predominantly smaller operators not in day-to-day contact with ratemakers. If this latter group of shippers is to make intelligent market decisions based on rail transportation costs, they must be assured the greatest possible access to reasonably available contract rate information.

With public disclosure concerning terms, conditions, rates, and the like, shippers also cannot obtain the necessary information to make legal challenge to discriminatory ratemaking. Either the ICC or the Congress must act soon to improve performance in public disclosure of contract rates.

While I have stressed some changes needed in the content and implementation of Staggers, I would like to conclude by flagging a more immediate concern. The ICC's recent actions reflect in our judgment not sensitivity to the needs of agricultural shippers for limited safeguards but instead a misguided and headlong rush toward total rail deregulation. Specifically, the ICC should be made to recognize that the Staggers Act does not confer the authority on the agency to deregulate rail shipments of grain and oilseeds unilaterally based upon a precedent set in the deregulation of boxcars.

Section 10505 of the act is being used as justification for deregulation of rail rates for boxcars. If the precedent is established, the railroads also may attempt to deregulate agricultural shipments further under the same pretext.

Total deregulation would be enormously disruptive to the grain marketing system and highly dangerous to the economic interests of grain and oilseed producers dependent on rail transportation. The ICC has demonstrated a lack of understanding and need for protection for agricultural shipments. Total deregulation would only make the present problems facing agricultural shippers seem small by comparison.

In conclusion, the problems facing agricultural shippers today under the terms of the Staggers Act are real and they pose a serious threat to the operating efficiency of the agricultural marketing system and the economic interests of all its participants.

This is not to say that we should give up on the act and attempt to rescind it. However, as it is currently being implemented, the act falls far short of the objectives spelled out by Congress in drafting the law.

The last 3 years have provided valuable experience for agricultural carriers and shippers. We should build upon that experience. Contract rates must be made public. Reciprocal switching and joint rates must be implemented. Railroad costs must be accurately and uniformly computed and made available to the parties who need them. Efforts to rush toward total deregulation without attention to the disastrous consequences for the farm economy must be curtailed. In short, the act must be carried out with the recognition of the special needs of the agricultural shippers for protections against inequitable rail actions.

This is not a call for preferential treatment for agricultural shippers. It is a call for a workable transportation policy that serves all interests, including shippers, carriers, and the national economy. If our rail policy can be fine tuned, we will all benefit. Thank you.

[The statement follows:]

STATEMENT OF MICHAEL J. SMITH, CARGILL, INC.

Thank you, Madam Chairman. My name is Michael Smith. I am Corporate General Transportation Manager for Cargill, Inc. I appreciate the opportunity to be with the subcommittee today to discuss the effects of the Staggers Act on agricultural shippers.

Like the other witnesses appearing before you today, Cargill has a major interest in the development of a sound national transportation policy. Cargill is a warehouseman, processor, merchandiser and transporter of agricultural commodities and other bulk commodities, with operations throughout the United States. The Staggers Act has had a profound effect upon the way we conduct our business, and it remains one of the most important policy questions facing U.S. agriculture today.

When the Staggers Act was enacted in 1980, many in the agricultural community welcomed its passage as an important step in the development of a more efficient, market-oriented rail transportation system. Unfortunately, however, it has become apparent that the act, coupled with policies and practices exercised by the Interstate Commerce Commission, has not provided adequate protections for grain shippers from the potential abuses of market power at the hands of the railroads. Far from promoting greater competition in rail service for agricultural shippers, the act has been used by the ICC as justification for deregulatory policies that leave agricultural shippers in a less competitive rail environment. From a competitive standpoint, many agricultural shippers have no realistic alternative to rail in moving their crops to market. In drafting the Staggers Act, Congress recognized this situation by retaining the concept of "market dominance." However, as the act currently is being implemented, the regulatory safeguards have not proven sufficient to protect the interests of agricultural shippers.

Few here today would argue that the current conditions justify a return to complete regulation of the rail industry. In many ways, the Act was an important step forward for both carriers and shippers. However, the experience of the past 3 years clearly has shown that additional refinements to rail policy are necessary. Many of the protections needed by shippers could be realized through administrative actions by the ICC. However, if the agency is unwilling or unable to redirect its actions to recognize the special needs of grain shippers the Congress may be forced to act to mandate these protections in unequivocal terms.

UNDERSTANDING RAIL GRAIN MOVEMENT

Before I offer my suggestions on changes to ICC policies and the act, I should provide some background information on the importance of transportation—particularly rail transportation—to grain marketing.

Grain is grown in a variety of geographical locations knitted together into one marketplace by a transportation network (truck, barge and rail) and central price-discovery mechanisms (futures markets). Grain is harvested in discrete, brief periods of time but consumed year round. The resulting agricultural marketplace is a delicate, complex, interrelated mechanism that can be severely disrupted if transportation and price-discovery institutions fail to function in an efficient, predictable manner.

Grain markets perform a number of functions in this setting. First, they provide a means for establishing grain values at any moment or location within the market (what people in the grain industry call "time and place utility"). Second, they provide the physical means of moving grains from areas or periods of surplus to areas or periods of deficit. Finally, they enable merchants to "make a market" that permits growers and consumers to make their individual selling or buying decisions at times convenient to each of them.

Grain futures markets are central to all of these activities. Futures markets are organized, public institutions in which differing judgments of buyers and sellers are brought together in centralized locations to "discover" prices by open outcry. These futures contract prices reflect these diverse judgments on the current value of grain for future delivery at these centralized locations for periods as much as 18 months forward.

These prices, in turn, become reference points for establishing the value of grain and grain products in specific market locations for specific delivery times. A country elevator in Iowa, for example, can relate the value of grain at his elevator to the value of that grain in a centralized market. While local supply-demand conditions influence the relationship between local and central market values, the key determinant of that relationship over time is the cost of transportation between the two.

Absolute—or what the industry calls "flat"—price levels for grain can fluctuate widely within a crop marketing year and between crop years. Flat prices change in response to supply or demand developments literally anywhere in the world. The price relationship between a local market and a futures market, however, has historically changed much less and much more predictably. This price relationship between local and central markets is called "the basis."

THE IMPORTANCE OF PRICE VISIBILITY AND PREDICTABILITY

Grain companies perform their marketing services at very narrow margins. They cannot afford exposure to the risks of large, unforeseen changes in flat prices. To minimize those risks, grain companies—both large and small—"hedge" their cash purchases and sales by making equal but offsetting purchases or sales of futures contracts. Since cash grain values and futures prices for the grain tend to move in parallel, hedging replaces the potentially large risk of flat price changes with the smaller, more predictable risk of changes in the basis.

For example, a grain company might buy corn at its elevator in Iowa for $2.50 per bushel and sell an equivalent quantity of Chicago corn futures at $2.75 per bushel. The company then owns that corn in Iowa at "25 under" the Chicago futures price. A month later it might sell the corn at only $2.40 per bushel—a 10 cent per bushel loss. The Chicago futures, however, would be bought back at the same time—say, at $2.65 per bushel, which yields an offsetting 10 cent per bushel gain. The grain company has protected itself against a decline in value through this hedge. Because grain merchants can transfer unwanted price risks through hedging, they are able to offer farmers (and grain users) markets (or grain) everyday efficiently and at narrow margins. The linchpin in this marketing system is the confidence of the marketplace in the predicability of the "basis."

Basis trading is the foundation for the ability to buy and sell grain 3, 6, 9, or 12 months forward without very large margins. It permits farmers to sell part of their crop forward and foreign customers to buy import needs months in advance. It enables grain merchants to buy from farmers when they don't yet have customers for the grain or to sell to customers grain they have not yet acquired. And, it enables all market participants to perform arbitrage activities in response to continually shifting market needs without locking themselves into potentially uneconomic positions.

The result is a fluid, highly efficient marketplace that moves grain from surplus to deficit areas while preserving a maximum of freedom of decisionmaking for all of the individual participants. At its heart are visible basis relationships that are reasonably predictable over time.

Since basis relationships depend primarily on transportation costs, this means that the U.S. grain marketing system depends pivotally on the visibility and predictability of future transportation rates. Here is where the current Staggers Act threatens to lead to an inequitable, inefficient grain marketing system by rail. Deregulation rail rates totally would simply compound the problem.

The problem can be illustrated by an example. Rates for trainload shipments to the seaboard today may run near 40 cents per bushel, which is at or near 110 percent of variable rail costs. The country elevator operator is operating at a much smaller margin, perhaps only 5 cents per bushel. But, if he sells grain today for delivery next January, he faces the risk that rail rates by then could be 63½ cents per bushel (175 percent of variable costs). This amounts to a 59-percent increase in rates and, more important, a potential increase in cost that is more than four times as large as his merchandising margin.

He is in a dilemma. His basis risk has become much larger than historically, and the only way to hedge that risk is to book rail freight to a particular market for next January, assuming that the rail carriers will cooperate. If he does that, however, he is locking himself into that market, and it may turn out that an entirely different market will offer a much more attractive price by next January when shipment occurs.

The result is a loss of flexibility and commensurate loss of efficiency in the marketing system. The system's strength is its ability to move the most inexpensive grain to the most economicial market. Yet, having booked his freight, the elevator operator has no way to sell out of that freight obligation and must ship. In the process, he is forced to bypass the opportunity to ship to a more attractive market. And the marketplace loses out by his performing on his obligation, since grain moves to an uneconomic destination while more pressing demand goes unsatisfied.

RAILROAD'S UNIQUE POSITION

Now, it might be asked why this is a more serious dilemma in rail freight that it is in a barge or truck freight, both of which are unregulated. It is, for several reasons.

First, trucks and barges move on public rights-of-way while railroads move on private rights-of-way. For most shippers served by rail, there is an almost complete barrier to entry for a competing carrier. By contrast, many truckers or barge carriers will be competing for the shipper's business. The existence of effective competition at the shipper's elevator among trucks or barges for his business is the shipper's assurance that the rate available for next January shipment will reflect the market. Knowing that, the shipper can make his own analysis of what rates are likely to be, and he always has access to a market that —through transportation price offers—is giving him information about future truck or barge rates. Transportation costs at the point of origination are predictable, reducing the risk faced by the shipper.

With the railroad, by contrast, the absence of competition at the shipper's elevator means he has no assurance that the rate next January will reflect a fair value for the desired rail freight. He also has no basis to assume that information about rates between now and then will provide a foundation for making a judgment about that future rate. In contrast to the shipper with access to barge or truck shipment, he has no way of knowing with certainty what the rate at the point of origination will be.

While it may be in the railroad's interest to serve shippers along its line competitively as a group and over time, no single shipper has any objective means of testing the competitiveness of that rate at any given time. Nor does he have any current means of ensuring that rate and service will be competitive when he needs it. Shippers will be required to devote extensive time and effort to monitoring rail rate actions merely to minimize the potential risk. For many shipper's who lack large logistical systems or large manpower pools, even this task will be impractical or impossible. And, the railroad is not equipped to handle hundreds of different requests for varying time slots and levels of service.

While large and small shippers alike suffer from these problems, the difficulties would be especially acute for smaller shippers. The smaller the shipper and the less he is in touch with other rates on that or other railroads, the greater his uncertainty and the higher the probability of inequitable treatment.

Second, if a shipper decides to book a rail rate for future shipment that subsequently proves to be uneconomic, he has no way to trade out of that position. By contrast, barge freight is actively traded. Truck freight is highly flexible in shifting to alternative markets. The shipper has meaningful economic options with barge and truck carriers but not with rail carriage. Without those options, the shipper's ability to perform curucial functions of arbitrage in constantly moving grain markets would be emasculated.

The importance of this arbitrage function in the grain and grain products industries cannot be overemphasized. While the pull of export demand might be the strongest market for a given shipper at one point in time, a local feed manufacturer or soybean processing plant could become a better market overnight. Similarly, shifts in ocean fright rates could make grain more valuable at Western seaboard elevators rather than at the Louisiana Gulf. These—and many other—changes go on continuously in grain markets. Merchants and shippers must have the freedom to respond quickly, both for their own continued profitability and for the efficient performance of the markeplace overall. And, at the heart of this economic arbitrage is a system of transportation markets at the shipper's elevator that exist for trucks and barges but not for rail carriage.

Finally, the number of elevators served primarily or exclusively by rail is much larger than the number served by barges. Recent surveys of elevator operations by the National Grain and Feed Association found that 46 percent of more of those surveyed had no realistic alternative to railroads for their shipments. As a result, the scope of the disruptiveness to the grain marketing system is much larger from an unforeseen change in rail rates compared to barge rates.

In other words, the railroad's private right-of-way prevents the development of an effective, competitive freight market for each shipper served by the railroad. There is, as a result, less information about future rate levels, no effective competition to ensure competitive rate and service when needed an no market in which to trade out of (or into) economic freight positions. This translates into a much higher level or unpredictability in basis relationships. Given the scope of the marketplace affected by rail rates, this unpredictability also means a much broader exposure of the shipping public to the adverse consequences of such uncertainty.

The problems are acute for all shippers, but they would be especialy acute for small shippers. Small shippers would be particularly disadvantaged because they have less information, less flexibility and less bargaining power than large shippers.

The problems of less visible, less predictable rail freight rates also can feed back into futures markets. Commercial users who hedge risks in futures markets depend upon reasonable predictability in the "spreads" between different contract months. The potential for unpredictable changes in rail rates creates new, unforseen risks to hedgers from these "spread" relationships.

At the least, this could increase marketing margins. At the worst, it could discourage hedging activities. Greater uncertainty means higher risks, which will translate into wider marketing margins over time. Disincentives to hedgers could reduce the liquidity of futures markets and impair their value as price-discovery and risk-transfer tools. These unnecessary burdens to place on farmers and grain users because the risk premium itself is not necessary to an efficient, profitable rail industry.

Unfortunately, there is no practical way to create the competitive conditions necessary at each shipping point to achieve deregulated rail rates without these disadvantages, short of making rail rights-of-way public. As long as rights-of-way remain private, barriers to competitive entry by other rail carriers will persist.

Some level of regulation, therefore, will be necessary in order to create and preserve the balance of shipper and carrier interests that effective competition achieves in the truck and barge movement of grain.

REFINEMENTS TO STAGGERS

With this background information in mind, the ICC—or Congress—should act to ensure certain modifications to current practices under the act.

As a starting point, the ICC should promulgate simple, understandable definitions of "captive shipper" and "market dominance" that enable shippers to litigate to protect interests they see as harmed and that will result in the creation of a body of interpretive case law.

For example, the National Grain and Feed Association recently proposed to Congress that market dominance be declared to exist on any route where the ratio of rate-to-variable cost is 5 percent more than the ratio that permits the ICC to investigate rates.

It should also be noted that simplifying the establishment of market dominance does nothing for the abused captive shippers as long as the ICC refuses to balance such a shipper's needs equitably against the needs of a revenue-inadequate carrier, as the act directs. Guidelines are needed by which to measure when a rate will probably be found to exceed a maximum reasonable level in a market dominant situation.

Similarly, in order to make "threshold pricing" a meaningful concept, a clear definition and well-defined, standardized formula for computing railroad costs must be established and used by all railroads for determining the revenue-to-valuable cost ratio of rates.

Many of the problems faced by shippers in determining whether or not rail rate actions are justified stem from the lack of a unified, consistent system of cost-accounting in the determination of railroad costs. Shippers, and to no small extent the railroads, would benefit enormously from having an established standard by which to measure railroad costs. Not only would shippers benefit from the remedial ability to scrutinize rail rate actions, but they also would improve their ability to judge the direction of future rates.

Also, the ICC should exclude the use of meaningless concepts like "geographic competition" or "product competition" as defenses, since they make no sense in the U.S. agricultural marketplace. The Commission also should enforce prohibitions against demand-sensitive or seasonal ratemaking.

In passing the act, Congress emphatically and specifically prohibited demand-sensitive rates for agricultural shipments. Yet, a variety of rail rate actions continue that can be interpreted only as demand-sensitive rates. For example, short-term branch line surcharges have been imposed. Contracts and rates have been imposed on as little as one-day notice. Rates have been published to apply for periods as short as 30 days. Rate decreases and discounts have been imposed to stimulate traffic.

Such actions only fuel the uncertainties surrounding rail rates and add to the inefficiencies of market operation. As noted earlier, the unpredictability resulting from demand-sensitive rates undermines the stability of the marketing process and ultimately works to the detriment of agricultural shippers and long-term rail interests.

Continued use of demand-sensitive rates also will undermine the increased use of contract rates. Without some general predictability in rates, shippers will not risk commitment to rail rates that could become highly unfavorable in a very short time span. And unlike other modes of transportation like the barge industry, no central marketplace exists for rail freight where prices can be quoted and discovered. In short, no method exists for trading out of economically untenable contracts.

Either the ICC or Congress must act to ensure reasonable joint rates and reciprocal switching arrangements in order to promote the most efficient movement of commodities among different rail service areas. Under current practices, shippers sometimes face a situation in which their markets are geographically attractive yet effectively closed because of the lack of cooperation among carriers or prohibitively high and economically unjustifiable rates and charges. This situation not only works against agricultural shippers. It also stifles economic opportunities for rail carriers.

Under terms of the act, revenue-inadequate carriers may impose surcharges or unilaterally cancel uneconomic joint rates on through routes. Railroads also may petition the ICC for an expedited consideration of requests to divide joint rate revenues or cancel joint rates under certain conditions, regardless of their financial position.

Agricultural shippers often must move their products over two or more railroads and thus depend upon joint rates to establish the rail rate framework for the national rate transportation system. In many cases, the joint rates determine the ability of shippers to be competitive in markets far removed from the point of origin.

Unilateral abandonment of established joint rates in favor of changeable single-line rates thus not only creates an unpredictable rate climate for agricultural marketers but also damages the ability of U.S. agricultural products to compete in highly competitive international markets.

The ICC may require railroads to enter into reciprocal switching agreements where such agreements are found to be "practicable" and "in the public interest." The ICC also is authorized to establish conditions and compensation for the service, if the carriers are unable to do so.

In some instances, railroads have charged exorbitant switching fees that have the effect of limiting or restricting shippers to certain lines.

Railroad actions that attempt to substitute railroad judgment for marketplace economics in determining transportation patterns for commodities damage the overall efficiency of the marketing system. Attempts to channel agricultural shipments to or away from specific lines through artificial devices such as unrealistic switching fees are costly impediments to efficient rail service and agricultural marketing.

These anti-competitive activities by the carriers also aggravate the captive-shipper problem and increase the need for residual maximum reasonable rate regulation. The authors of the Staggers Act contemplated more intra-modal competition rather than less and intended that competition would become the regulator where possible.

The ICC should prohibit cancellations of joint routes and rates, reciprocal switching and other pro-competitive cooperative arrangements where the carrier's motivation is anticompetitive and sound economic reasons for such actions cannot be demonstrated.

Reciprocal switching should be available at all locations served by more than one carrier at fees based upon the actual cost of providing the service.

The ICC also must require carriers to establish a nondiscriminatory system for the use and compensation of private hopper cars. About half of the U.S. hopper-car fleet currently is privately owned. Attempts to restrict the use of these cars or deny compensation for their use also are potential limits on the most efficient and economical use of equipment.

CONTRACT-RATE DISCLOSURE

I especially want to call your attention to my two final recommendations. They are among the most important steps that can be taken to benefit agricultural shippers both in the short term and the long term.

The first of these is the need for full public disclosure of contract rates for rail transportation of grain. As I discussed earlier, the unique nature of the grain-marketing system and the unique role of the railroads in the grain-transportation network require rate visibility and predictability, if the agricultural marketing system is to operate efficiently for all participants.

Congress recognized this need for rate visibility when it included a provision in the act requiring public disclosure of "essential terms" of rail transportation contracts involving agricultural commodities. However, the ICC's rules in this area fall far short of providing the rate visibility needed to protect the interests of grain shippers.

Railroads may enter into contracts with shipppers to provide specified services under specified rates and conditions subject to ICC review. The agency will publish nonconfidential information that provides "essential terms of the contract" in tariff form to the general public.

The ICC has not resolved the uncertainties surrounding implementation of the section, thus making it impossible for shippers to review existing contract terms to determine if the basis exists for complaint against unreasonably discriminatory ratemaking or destructive competitive practices by the railroads.

Without full disclosure, shippers cannot adequately determine if they are being offered contract terms similar to those negotiated for similar commodities, or if the contract creates a destructive competitive practice or unreasonable discrimination.

Contract disclosure is important to all shippers and essential for the success of many smaller shippers. All shippers must be capable of assessing and comparing rate actions to protect against discriminatory actions. But also of importance during periods of extreme rate fluctuations, shippers must be able to have prompt and accurate information on ratemaking agreements in order to bring order to their own pricing decisions. Price predictability (at least within general parameters) is a keystone of agricultural marketing.

Shippers who deal with railroads on a regular basis will be better able to gauge the prospects of rate actions than those predominantly smaller operators not in day-to-day contact with rail ratemakers. If this latter group of shippers is to make intelligent marketing decisions based upon rail transportation costs, they must be assured the greatest possible access to reasonably available contract rate information. Essential information necessary to make sound judgements on the competitiveness and nondiscriminatory nature of existing contract rates must be provided.

Without public disclosure concerning terms, conditions, rates and the like, shippers simply cannot obtain the information necessary for a legal challege to discriminatory ratemaking. Either the ICC or Congress must act soon to improve performance in public disclosure of contract rates. Cargill and eight other parties from the agricultural sector have challenged the ICC's rules in the U.S. Court of Appeals.

STEMMING THE RUSH TO TOTAL DEREGULATION

The promulgation of improved rules for the disclosure of contract rates would be of immediate and lasting benefit to all agricultural shippers. However, agricultural shippers also need long-term protection from the ICC's misguided efforts to rush toward total rail deregulation. Specifically, the ICC should recognize that the act does not confer the authority to the agency to unilaterally deregulate rail shipments of grains and oilseeds based upon precedents set in the deregulation of coal or boxcars.

Section 213 (10505) of the act gives the ICC authority to exempt a person, class of persons or transaction or service from regulation when the agency determines: (1) regulation is not necessary to carry out the transportation policy of section 10101a of the Act; (2) the transporation or service is of limited scope; (3) regulation is not necessary to protect shippers from the abuse of market power.

While the section may have been intended as a menas to promote deregulation of unnecessarily regulated rail traffic, it nevertheless could be used in conjunction with the ICC's liberal deregulatory posture to promote deregulation in areas where regulation remains necessary. Agricultural shipments are a classic example.

Many members of the agricultural community fear that the ICC will use its decisions on export coal and boxcar deregulation as precedents for the deregulation of these agricultural goods. As I have explained, total deregulation would be enormously disruptive to the grain marketing system and highly dangerous to the economic interests of grain and oilseed producers dependent upon rail transportation. The ICC has demonstrated a clear lack of understanding of the need for proteciton for agricultural shipments. Total deregulation could only make the present problems facing agricultural shippers seem small by comparison.

CONCLUSION

The problems facing agricultural shippers today under terms of the Staggers Act are real, and they pose a serious threat to the operating efficiency of the agricultural marketing system and the economic interests of all its participants.

This is not to say that we should give up on the act and attempt to rescind it. However, as it is currently being implemented, the act falls far short of the objectives spelled out by Congress in drafting the law. In order to improve competition and increase the efficiency of the rail transporation system for the benefit of carrier and shipper alike, we must make some adjustments to the act.

The last 3 years have provided valuable experience for agricultural carriers and shippers. We should build upon that experience. Contract rates must be made public. Reciprocal switching and joint rates must be protected. Railraod costs must be accurately established and made available to the parties who need them. Efforts to rush toward total deregulation without recognition of the disastrous consequences for the farm economy must be curtailed. In short, the act must be carried out with the recognition of the special needs of agricultural shippers for protections against inequitable rail actions.

This is not a call for preferential treatment for agricultural shippers. It is a call for workable transportation policy that serves all interests, including shippers, carriers and the national economy. If our rail policy can be fine-tuned, we all will benefit.

Thank you once again for the opportunity to be with you today. I will be happy to respond to any questions you may have.

Senator **Kassebaum**. Thank you very much, Mr. Smith. I suggest that we hear all three witnesses and testimony and then we will ask questions. Mr. Gregg.

Mr. **Gregg**. Senator, I want you to thoroughly understand he did not write my speech, but it sounds like it.

Senator **Kassebaum**. I think maybe he could have, though. Is that right?

Mr. **Gregg**. Well, I wasn't with him. It suited me fine. My name is Joseph B. Gregg, and I am appearing before you today on behalf of the board of trade of Kansas City, Mo. Our appearance is to point out some of the defects of the Staggers Rail Act of 1980. They are the same problems that we addressed and spoke against before the act was passed.

I have been a member of the board of trade for 48 years, so I have seen all kinds of disruptions in the marketing chain over a long period of time, but I believe these things in the Staggers Act have created more problems than I have ever seen before and still are doing so.

During 1980 the board of trade was deeply involved in matters leading to what is now called the Staggers, and we raised strong objections to many points. We spoke strongly against joint rate route cancellations, rapid tariff change, reciprocal switching, and contract rates.

In the cancellation of joint route rates, the act has precipitated battles amongst the railroads due to cancellation of these rates. The cancellations have deprived shippers of routing, gateways, economical competitive routes, and their right to route their own freight. The ICC is allowing these cancellations and further the practice of being neglectful of letting the shipper find the proper market for the grain. To allow unilateral withdrawal on joint route or joint rate was not intended to do away with railroad competition, yet this is the result.

We do not feel it was the intent of Congress to be an instrument for the carriers to cushion themselves on competition on a joint route. Fortunately the Kansas City market has not been directly involved in such cancellations yet, but what has been done has weakened the links of our national rail transportation system. If a system came about where each railroad operated like a separate entity due to joint rate route cancellations, there are many who feel that eventually that would lead to the nationalization of the entire system. If joint rate route agreements are to be terminated, they should be terminated by agreement of each party, including the user of the rate. The Staggers has allowed the cancellation of joint rate routes and it should be rescinded. The same holds true in the cancellation of reciprocal switching agreements.

We also addressed the matter of critical need of adequate notice of rate changes. The notice periods used to be 30 days, which was perfectly satisfactory. Now it is only 10 days on a decrease and 20 days on an increase. Often a new rate is in effect before the users even know about it because of the difficulty of getting the tariff with the changes. The law requires that the tariff be sent to the subscribers the same day it is filed with the Interstate Commerce Commission. Experience shows this has not been done. If the date 10 days prior to the effective date is the same day that rate changes are filed with the ICC and sent to the subscribers, the trade would not be getting our copies of the changes till 5 or 6 days later, and that is our actual experience. The Staggers should be amended to require a minimum of 20 days notice for a decrease or an increase and preferably 30 days.

We believe the ICC abused the intent of section 10505 when they exempted boxcar traffic from regulation. The opposition to this exemption was quite large, but the ICC did not seem to care. The boxcar exemption was requested by Conrail, Conrail wanted it, and Conrail got it.

I would like to point out that Senator Zorinski on September 30, 1980, and it was quoted in the Congressional Record of that date, made the following remarks about the Staggers Act: "This legislation is offered to us today as a twisted and tortured mockery of reasonable deregulation, and it is a Conrail bailout." These words are applicable today.

The philosophy of the ICC, apparently being very partial to Conrail and ignoring the needs of all shippers, is unconscionable. Conrail was the first railroad to cancel joint route rate agreements, the first one to ask for boxcar deregulation, which was strongly opposed, but the ICC let Conrail prevail in both cases.

Conrail should not be placed beyond the law because it was a money loser, and Government involvement with Conrail should not be a determining factor. There have been at least 22 Federal court hearings challenging the ICC action on boxcar deregulation, which makes one believe they could have erred.

I would like to point out that Chairman Taylor dissented in this matter as he has in others. Chairman Taylor, I am not picking on you in this statement, but I am sure after your commission.

Mr. TAYLOR. I was just going to ask you, maybe instead of keeping on saying the ICC, you could talk about my colleagues.

Mr. GREGG. I understand that. In 1980 we spoke out strongly pertaining to contract rates. We challenged contract rates because they would be discriminatory against the small and captive shipper, but the law as it is now written allows contract rates. It permits a challenge to contract rates on agricultural commodities for reasons of discrepancy, inability to fulfill carrier obligation or to destructive competition, but actually information released about contracts is totally secret and inadequate for a shipper to determine if a challenge is warranted.

I attached to my statement on the back a copy of a contract rate, and if a shipper can determine from that document where he is being discriminated against, I fail to see it. I wish you would take a look at that contract and see if you can determine anything from the contract.

Mr. TAYLOR. I agree with you.

Mr. GREGG. Even if the rates were public, what relief would the small shipper have? Because as the ICC is constituted, I doubt very much if we would get any relief, and the railroads would find a way not to give the small shipper competitive rates.

I can envision one of these small shippers out here asking for a hearing before the Interstate Commerce Commission to complain about discrimination, and I think he would have about as much chance as a snowball has in Haiti.

It is the feeling of many that the ICC has not interpreted the act as intended by Congress but have made their own interpretations which has created many of these problems. It is the feeling of many that the ICC is so proderegulation that they are ready to throw the baby out with the bath water. The administration and

Congress should be very careful as to what qualifications people have that are approved for this Commission. They certainly should have some type of transportation background and come from all segments of the industry.

Now, here is a point that I must stress. Let us not forget that all of the contracts on U.S. hard winter wheat, internationally and domestically, worldwide, are based on the Kansas City futures market, and the Commission and Congress must not allow these railroads to do anything to keep that from being a viable market.

I thank you very much, Senator Kassebaum, for letting me appear.

Senator **KASSEBAUM**. Thank you, Mr. Gregg. Mr. Gans.

Mr. **GANS**. My name is Mike Gans, and I am a farmer and rancher from Bennington, Kans., which is 13 miles north of Salina. I have been farming and ranching all of my adult life and harvested my first wheat crop in 1968. At the present time I farm approximately 2,000 acres of wheat and in addition raise silage and feed for cattle. I also feed and pasture several thousand head of cattle.

I am not a lawyer, accountant, transportation specialist, or lawmaker. I don't know much about the Staggers Rail Act of 1980 other than what I have read in the news accounts about it, but I know a little bit about growing wheat and raising cattle. An integral part of my overall business is my relationship with the local country elevator, and I think the future of that elevator is threatened by what Staggers has allowed, rail freight contracts.

As I have said, I am not well-versed on the Staggers Rail Act, but I have noticed a substantial difference in the paying price that I can get for my grain at Bennington compared to what is available at terminal facilities in Salina. The difference has increased dramatically in 1982 and 1983 when compared to the spread that existed in 1981 and for that matter when I first started farming.

In 1981 there was generally a 10-cent difference between the paying price at Bennington compared to the paying price at the Bunge Terminal Elevator in Salina. Since it would cost me about 6 cents a bushel to truck to Salina, it really wasn't worth my time to think about marketing my grain in Salina.

However, since 1982, the difference in paying price, which had traditionally been in the range of 8 to 10 cents a bushel, has doubled. It is now about 20 cents per bushel. To me, when the difference doubles in 1 year, as it did from 1981 to 1982, I think something must have happened to account for that. I have asked my local elevator manager what was happening, what was contributing to this difference. He has told me that he is having to compete with a rail contract rate that is only available to the terminal facilities located in Salina, that he is taking the least margin that he can to try and stay as competitive as possible, but that the difference in paying price that can be offered by these terminals is directly related to a significantly cheaper freight rate that only they get.

As you see, Senator, there is some incentive for me as a producer to sell my grain to a terminal facility in Salina that offers a greater paying price. If the difference in paying price as shown in my example is about 20 cents per bushel on the average, I can make an additional $4,000 on 20,000 bushels of grain. The only reason I have not done this in the past and hope I will not have to in the future is because I think the extra $4,000 that I could make is more than offset by the possible loss of other services that I get from my local country elevator.

First, I would not make an extra $4,000 if I sold that 20,000 bushels of grain to the terminal in Salina. I have to get it to Salina first. Right now that cost is 6 cents per bushel. For 20,000 bushels, that is $1,200, so I really can only expect to net an extra $2,800 for the sale of that grain. I will be the first to admit that $2,800 is $2,800 and any wheat producer would like to get that extra money, and many from my area do sell in Salina for that reason. But I do not really think that I will realize anything out of that $2,800 if the Bennington elevator is not there.

I rely on my local country elevator for storage. I do not have any farm storage capability. I rely on commercial storage available at my local elevator for this service. Many times terminal facilities will not accept anything other than cash grain so they cannot be relied upon to provide for my storage needs.

Fertilizer, I buy all my fertilizer from my country elevator. Last year alone I bought approximately 850,000 pounds of fertilizer. The elevator not only sells the fertilizer but also offers custom application services. If I cannot get this service locally in Bennington, I am sure I will have to pay more to get it out of Salina. I cannot quantify what the extra cost would be, but if it costs $1,200 to ship 20,000 bushels of wheat from Bennington to Salina, it has got to cost a significant amount to get the 425 tons of fertilizer from Salina to my fields around Bennington.

My local elevator also offers feed-mixing service. Last year I bought approximately 450,000 pounds of feed. If I have got to get the feed from Salina, I suggest to you that I will be paying more for either the feed or I will have an additional transportation expense that I do not presently have.

In retail sales, my local elevator sells various hardware, veterinarian supplies that I use in my farming operation. If I need barbed wire or vet supplies, I can get it locally. If my country elevator goes out of business, I will have to send one of my hired hands to Salina for these supplies, again at additional expenses for wages and transportation.

The storage of the wheat on the farm, I guess there is no way that a producer of my size can afford the sizable investment for bins, legs, trucks, and everything. The most important thing about it is the time involved. There is no way possible that a producer of my size or capabilities could truck my grain to Salina if there is no Bennington elevator.

If we do have a rail transportation policy that eliminates the country elevator, with the service that I have talked about here today, I really wonder what will the effect of the loss on the producer be for the long term. Where is the price competition going to come from if country elevators are eliminated and all that is left is a few terminals? Is a producer going to be saddled with making large substantial investments for on-farm storage and upgrade transportation equipment at a time when he can lest afford additional investments and overhead simply to fit into a new system?

Will a producer be next on the list behind elevators and railroads to be saddled with a bigger-is-better economic change?

I can assure you that as a producer, if I am not willing to accept any short-term benefit of increased prices that, as I am told, the enactment of Staggers has been responsible for without either knowing or having a pretty good idea what the answers to these questions are.

I thank you for giving me a chance to testify before your committee.

[The statement follows:]

STATEMENT OF MICHAEL H. GANS

My name is Michael H. Gans. I am a farmer from Bennington, Kans., which is about 13 miles north of Salina. I am 36 years old, married, and have two children. I have feed farming all of my adult life and harvested my first wheat crop in 1968. At the present time, I farm about 2,000 acres of wheat and in addition raise silage and beef for cattle. I also feed and pasture several thousand head of cattle. I have three full-time employees to help me in my farming operations.

I am not a lawyer, accountant, transportation specialist, or lawmaker. I don't know much about the Staggers Rail Act of 1980 other than what I have read in news accounts about it. But I do know something about growing wheat, raising cattle, and managing my business in Bennington, Kans. An integral part of my over all business is my relationship with the local country elevator, Bennington Agri Services, and I think the future of that elevator is threatened by what Staggers has allowed: rail freight contracts.

As I said, I am not well versed on the Staggers Rail Act; but I have noticed a substantial difference in the paying price that I can get for my grain at Bennington, compared to what is available at terminal facilities in Salina. The difference has increased dramatically in 1982 and 1983, when compared to the spead that existed in 1981, and for the matter when I first started farming.

In 1981, there was generally a 10-cent difference between the paying price at Bennington compared to the paying price at the Bunge Terminal Elevator in Salina. I checked three successive Fridays in January 1981 and discovered that the differences in the paying prices were as follows:

Date	Bennington price (per bushel)	Bunge price (per bushel)	Difference (cents)
Jan. 2, 1981	$4.15	$4.27	12
Jan. 16, 1981	4.14	4.23	9
Jan. 30, 1981	3.83	3.91	8

It always appeared to me that these differences were based on difference in freight rates available to the facilities because of where they were located. Bennington is simply 13 miles further from the Gulf or Kansas City than Salina is and I always figured that the difference in paying price, being somewhat constant around the 10-percent range, was based upon a little cheaper rate and maybe a cent or two lower margin because of significant volumes involved at the terminals in Salina. In any event, since it would cost me about 6 cents a bushel to truck to Salina, it really wasn't worth my time to think about marketing my grain in Salina.

However, since 1982, the difference in paying price, which had traditionally been in the range of 8 to 10 cents per bushel, has doubled: it's now about 20 cents per bushel. To prepare for this hearing, I checked paying prices that were available to me at Bennington and again at the Bunge Terminal in Salina on several days in January and July 1982 and 1983 and they reflect the following:

Date	Bennington price	Bunge price (per bushel)	Difference (cents)
Jan. 8, 1982	$3.98	$4.21	23
Jan. 15, 1982	3.94	4.16	22

Date	Bennington price	Bunge price (per bushel)	Difference (cents)
Jan. 29, 1982	3.87	4.10	23
July 2, 1982	3.35	3.49	14
July 16, 1982	3.42	3.61	19
July 30, 1982	3.26	3.45	19
Jan. 7, 1983	3.57	3.81	24
Jan. 14, 1983	3.57	3.80	23
Jan. 28, 1983	3.54	3.79	25
July 1, 1983	3.28	3.49	21
July 15, 1983	3.27	3.46	19
July 29, 1983	3.33	3.52	19

To me, when the difference doubles in one year, as it did from 1981 to 1982, I think something must have happened to account for that. I've asked my local manager, Jerry Underwood, what was happening, what was contributing to this difference. He has told me that he is having to compete with a rail contract rate that is only available to the terminal facilities located in Salina; that he's taking the least margin that he can to try to stay as competitive as possible, but that the difference in paying price that can be offered by these terminals is directly related to a significantly cheaper freight rate that only they get. I know more than one railroad serves Salina and only the Union Pacific serves Bennington, so maybe that accounts for some of the difference.

As you can see, Senator, there is some incentive for me as a producer to sell my grain to a terminal facility in Salina that offers a greater paying price. For instance, if the difference in paying price, as shown in my example, is about 20 cents per bushel on the average, I could make an additional $4,000 on the sale of 20,000 bushels of grain. The only reason I haven't done this in the past, and hope I will not have to in the future, is because I think the extra $4,000 that I could make is more than offset by the possible loss of other services that I get from my local country elevator.

First, I wouldn't make an extra $4,000 if I sold that 20,000 bushels of grain to the terminal in Salina. I have to get it to Salina. Right now that cost is 6 cents per bushel. For 20,000 bushels, that's $1,200, so I really can only expect to net an extra $2,800 for the sale of that grain. I'll be the first to admit that $2,800 is $2,800 and any producer would like to get that extra money, and many from my area do sell in Salina for that reason. But I don't really think that I'll realize anything out of that $2,800 if the Bennington elevator isn't there.

I rely on my local country elevator for many things. Among them are:

1. *Storage.*—I don't have much on farm storage capability. I rely on commercial storage available at my local elevator for this service. Many times, terminal facilities won't accept anything other than cash grain so they can't be relied upon to provide for my storage needs.

2. *Fertilizer.*—I buy all of my fertilizer from my country elevator. Last year alone I bought approximately 850,000 lbs. of fertilizer. The elevator not only sells the fertilizer, but also offers custom application services. If I can't get this service locally in Bennington, I'm sure I'll have to pay more to get it out of Salina. I can't quantify what the extra cost would be, but if it costs $1,200 to ship 20,000 bushels of wheat from Bennington to Salina, it's got to cost a significant amount to get 425 tons of fertilizer from Salina to my fields around Bennington.

3. *Feed.*—My local elevator sells feed and has a custom feed mixing service. Last year I bought about 450,000 lbs. of feed. If I've got to get the feed from Salina, I suggest to you that I will be paying more for either the feed or I will have an additional transportation expense that I don't presently have.

4. *Retail sales.*—My local elevator sells various hardware and veterinarian supplies that I use in my farming operations. If I need barb wire or vet supplies, I can get it locally. If my country elevator goes out of business, I'll have to send one of my hired hands to Salina for these supplies, again at additional expense for wages and transportation.

As I have said, I can't quantify what I think would be the additional costs that I would incur if my local elevator wasn't in business. But I think I am in about a breakeven position right now.

While it is difficult for me to quantify what my extra costs would be for the services I get from my local elevator it is impossible for me to judge what the intangible costs would be on the town of Bennington if the elevator weren't there. Bennington is a town that has an approximate population of 560 people. The primary businesses in town are the Bennington State Bank and the elevator. I suspect both of these business are our major employers outside of the farming community itself. I just don't know what the impact would be on the community if the elevator were to go out of business—but I can guarantee you that I don't want the opportunity to find out.

Another reason I have chosen not to truck my grain to Salina for the additional paying price is that my operation is simply not geared for those kinds of movements, and I simply don't care to make the substantial investment required to make it compatible with the direct farm to terminal movement. I presently have about six grain trucks that I can haul grain with. I suspect I couldn't get $3,500 for the whole lot of those trucks; but they can make it to Bennington to the elevator; have a short turnaround time to dump the grain; and make it back to the farm for the next load during harvest season. But I doubt that they could make it to Salina.

I know of some producers who have invested in tractors and grain trailers to truck their own grain. Given current economic conditions on the farm, that type of investment is an additional overhead expense that I want to avoid. Additionally, I simply couldn't afford the time or expense involved in such direct movements during harvest season. I know of some truckers who hauled semi loads of grain during the last harvest season who told me they waited in line for 8 o'clock in the morning to 2 o'clock in the afternoon at the Bunge terminal in Salina just to dump a load of grain. I simply don't think its feasible to have a grain gathering and marketing system that bypasses the country elevator.

If we do have a rail transportation policy that eliminates the country elevator, with the services that I have talked about here today, I really wonder what will be the effect of that loss on the producer on the long term.

Where is price competition going to come from if country elevators are eliminated and all that is left is a few terminals?

Is the producer going to be saddled with making substantial investments for on-farm storage and upgraded transportation equipment, at a time when he can least afford additional investments and overhead, simply to fit into a new system?

Will the producer be next on the list, behind elevators and railroads, to be saddled with a "bigger is better" economic change? I can assure you that as a producer, I am not willing to accept any short term benefit of increased prices that, as I am told, the enactment of Staggers has been responsible for, without either knowing or having a pretty good idea what the answers to these questions are.

Thank you for giving me the chance to testify before your committee. I'd be happy to answer any questions that you might have.

Senator KASSEBAUM. Thank you very much. I appreciate the comments of all three and I am sure Chairman Taylor has some comments he would like to make and exchange of questions with you. I would like to ask a couple of questions. First, and maybe Mr. Gans started with a comment which I think is very interesting because you are speaking from the reality of what has happened directly to you, but you said that trucking rates, for instance, have been about 6 cents per bushel.

Mr. GANS. Right.

Senator KASSEBAUM. They have not changed?

Mr. GANS. They have not changed much that I know of in the last year or so, but I could not say for certain.

Senator KASSEBAUM. Do you feel that a public disclosure of contract rates would be of benefit to you? Do you see this alleviating the problem that you have?

Mr. GANS. The only way I can speak on this is from my view, which is I spend it in the country producing grain. If it would help the country elevator to continue and be there, I say yes, otherwise, I really do not know because I am not that familiar with it. The thing I am familiar with is the price differential on the wheat I grow and what I get for it in Salina.

Senator **KASSEBAUM**. Has this made quite a bit of change as far as the others in the area going to Bennington? You said you still of course——

Mr. **GANS**. Yes and no.

Senator **KASSEBAUM** [continuing]. For the reasons you said that you trade at Bennington.

Mr. **GANS**. Yes; I trade there simply because it is closer. Now, I live kind of on the north and east of Bennington where most of our farmland is, but it would definitely make some difference to other producers in between Bennington.

Senator **KASSEBAUM**. They are shipping to Salina?

Mr. **GANS**. Not shipping, they are——

Senator **KASSEBAUM**. Trucking.

Mr. **GANS**. Trucking. But they have run into several problems doing that.

Senator **KASSEBAUM**. What?

Mr. **GANS**. Well, I know of trucks that were in line from like 8 in the morning till like 4 in the afternoon to get dumped during harvest.

Senator **KASSEBAUM**. Was this in Salina?

Mr. **GANS**. Yes, yes.

Senator **KASSEBAUM**. I would like to ask any of the other panelists to respond. Do you believe that public disclosure, as everybody was speaking of, do you regard it as the major source of competitive disadvantage? Do you think this would indeed improve this situation?

Mr. **GREGG**. Well, Senator, disclosure might be a help, but as I have said before, with the Commission such as it is, I do not see how a small shipper or a captive shipper at the present time would get absolutely no relief from that Commission.

Senator **KASSEBAUM**. If they took their case to the Commission?

Mr. **GREGG**. Yes.

Senator **KASSEBAUM**. Let me ask you, would a small elevator feel that they even with that information could spend the money to take the case?

Mr. **GREGG**. No; I was going to add to that that how can a small elevator afford the costs of an attorney or a practitioner who is allowed to appear before your Commission? He cannot afford it. And I think Mr. Gans pointed out a lot of these railroads may feel, and their greed may cause this feeling, that there should only be 1 or 2 or 3 or maybe 10 or 12 elevators in the whole State of Kansas. I am telling you that you will never get a wheat harvest handled by having to truck grain all over the State to get to these 10 or 12 elevators. I think it is total discrimination against the country elevator, and I doubt if a disclosure will do it. I think they have to be eliminated.

Senator **KASSEBAUM**. You think full disclosure should be eliminated?

Mr. **GREGG**. No, no. I think the contract rates should.

Senator **KASSEBAUM**. Totally eliminated?

Mr. **GREGG**. Yes.

Senator **KASSEBAUM**. It is fair to do that just on grain then?

Mr. GREGG. Well, I think the Commission has deregulated many other subjects, but they have not deregulated grain, and God help us if they do.

Senator KASSEBAUM. I would like to ask you regarding your testimony, Mr. Gregg, you said that you felt the joint rates should all be changed.

Mr. GREGG. No. I said they should not be canceled.

Senator KASSEBAUM. Well, should not be canceled.

Mr. GREGG. Yes, ma'am.

Senator KASSEBAUM. Changed from the procedure that it is handled now, but do you think that is appropriate for all joint rates? Is this something that again by statute should be designed? Should there not be some flexibility?

Mr. GREGG. I can only speak, Senator, as to grain. I cannot speak as to coal and other products, but I can speak to grain. We always in this system, and I have been in it a long time, could go from point A to point B even though it might cause the use of one, two or three railroads, and they all had joint route rate agreements. You cancel those, you cannot get from point A to point B if that railroad does not go there, if they cancel those rates. As I said, we have not had them canceled in Kansas City, so we have not been affected so far, but all of this is fear with us. I mean the railroads have gone rampant in the last year on what things they are doing, and it is really the shipper be damned.

Senator KASSEBAUM. Yet they need the shipper.

Mr. GREGG. They do not act like it.

Senator KASSEBAUM. Let me ask another question of your testimony. You mentioned the need for rapid changes in rates.

Mr. GREGG. My point was there that we used to have 30 days' notice on the change on a rate increase or a decrease. Then they reduced it to 20 days on an increase and 10 days on a decrease. The law says that we should get those tariffs and know what is in the tariff and it should be sent to us the day the tariff is filed. We are now receiving those tariffs in the Kansas City Board of Trade Transportation office as late as 5, 6, 7 days, and the tariff goes into effect before we have had the tariff maybe 3, 4, days. So we do not know what is in the tariff.

Senator KASSEBAUM. If indeed you got the notice earlier, it would not be such a problem?

Mr. GREGG. It would not be such a problem, but I think 10 days is too short, 20 days for both would be reasonable, but we would prefer 30.

Senator KASSEBAUM. Do you think this, however, might not put the railroads at a disadvantage as far as the trucking industry? Would you not believe there might be some meaningful flexibility there?

Mr. GREGG. You know, I have heard that old story about they have just got to compete against the trucks. There is not any man in the grain business going to use trucks over rail unless he is compelled to buy the railroad. That is my personal feeling.

Senator KASSEBAUM. Mr. Smith, I would like to ask you, how much grain that Cargill ships is contract?

Mr. SMITH. To be real honest with you, I do not know.

Senator **Kassebaum**. A large percentage, a major percentage of the grain?

Mr. **Smith**. Yes, it is. I guess a way to think about Staggers, is that it was not bad law per se. Where the railroads came from was not any good. A return to complete regulation will be as stifling as where we came from. There is a tradeoff, I think, in all this I guess, just to put it in perspective. Even in a recession, railroads are doing better than they have, and we have all undergone tremendous change in order to accommodate that sort of a thing. Cargill is here because we have country elevators. Cargill is here because we have terminals. Cargill is playing in the ballpark or in the environment that is here to the extent that it can, because it has competitors as well. But it is not time to stop and say, gee, what have we done? What have we wrought? What is all this? What is the meaning of it? If you stop for a while and smell the roses and just see where we have been, maybe we need to go further, maybe we need to retrench some, but there is some fine tuning necessary because, very frankly, if deregulation in this form today is not good for the most of us or for the general public, per se, in the long term it is not any good.

Senator **Kassebaum**. Well, that is the purpose of the oversight hearings. I would agree with you. It is just as frustrating, let me say, for those in the House and Senate who have been involved in deregulation as I have, the railroads, the airlines, trucking industry, the financial industry when I was on the Banking Committee, and it can be very frustrating because on the one hand people are saying get Government off our backs and let free enterprise rein. On the other hand, for many aspects of our economy, regulation has existed for a long period of time. Certainly that has been true with the ICC in the role it has played in transportation. In a way, it is a happiness and security blanket and it is very difficult when we start to make these changes and we do, I think, have to continually evaluate what effect it has, if it is doing more harm than good and how some changes can be made and made equitably, because as it affects the grain industry, it affects coal, it affects timber, it affects all those things. Even though there are differences in the commodities, essentially some of the same concepts, of course, prevail in all, and that is the purpose of these hearings, and I think the testimony that all three of you made a very dramatic one as far as some of the things that all three of you feel strongly about that need to be changed. Chairman Taylor, what do you have to say?

Mr. **Taylor**. Well, I would like to ask a couple of questions if I might. Mr. Smith, I guess you probably are aware of it, one of the things my colleagues did was to determine when we got into the exemption area that we were going to exempt agricultural commodities, but we were not going to exempt grain or soybeans or sunflower seeds. We particularly picked those things out. About, I do not know, 30, 60 days later, we would up with a boxcar exemption, Now, I have discovered that a certain amount of grain still moves in boxcars, particularly in and out of the Dakotas. I ran the waybill sample for Kansas in 1981, and I found that about 7.9, 8 percent of the corn, and these are movements in and out of Kansas, moves in boxcars and about 3 percent of the soybeans, not very much wheat. I was not able to get an update on those figures. What is going on today? Is there any great amount of grain, corn, wheat, any of those commodities that presumably we did not want to exempt, that is moving in boxcars? As a result of the boxcar exemption, to me this was doing one thing for the right hand and something else for the left hand, which is unwarranted in my view. Could you tell me how much is being moved in boxcars?

Mr. SMITH. I would like to be able to answer you, but very honestly, I cannot. However, the impression, at least for our account, is very little.

Mr. TAYLOR. Not much wheat, some corn perhaps?

Mr. SMITH. Not very many bulk whole-grain commodities are moving in boxcars at all. I think that as a last resort this would be something to do, but very frankly I think a lot of the car dumpers and the machinery that the marketplace had to handle that equipment is now in disrepair, I am sure, if not removed altogether.

Mr. TAYLOR. On the other hand, the forest products in and out of Kansas from our 1981 waybill sample indicate that 100 percent of those come in and out in boxcars and they are, along with agricultural shippers, in the same boat insofar as some of these problems we were talking about, certainly in this complaint area.

I get the impression from the three of you, and I want to be sure that I am correct in this, that insofar as the country elevator proposition is concerned that you'd like to see that resolved on the basis of farm economics—whether ultimately it turns out to be a better system to have a few terminal elevators as opposed to many country elevators or something in between or the present system remain. You would like to see that predicated on what actually is the most efficient way to handle a proposition from a farm econmics point of view, rather than on the basis of the ICC's interpretation of the Staggers Act. Is that too broad-brushed an analysis, or is that pretty much where all three of you are coming from?

Mr. GANS. As a producer, there would be no way we could have, say, subterminal elevators where the wheat would funnel into it over a larger area. Bennington is a little unique, it is kind of close to Salina, so it is a little hard to compare in some ways. But from an economic standpoint on the farm, I am sure you probably all heard, it is not the best and there is no way that the average producer could equip himself to even haul to a subterminal.

Just an example, we use old trucks to haul grain, they would bring nothing if you lined them up. They can make it the 10 to 12 miles to our country elevator, but there would be no way they could, say, make it 25 to 30 to a subterminal or terminal dump and get back to the field. If we were to gear up to take our wheat to a subterminal or a terminal elevator, I would say we would probably need a minimum of five to six semis because during harvest, if everybody is going there, there is going to be quite a line, and if they have to go very far, there is just no way they can make it and make it back, and the weather is so important.

So from my way of thinking, there is a lot of things I do not understand about the Staggers Act, I will be the first to admit it, but I do know from an economic standpoint on the farm in the small town, without our country elevators, it is going to be an entirely different story, and it would be the end of some producers, frankly.

Mr. **Taylor**. How do the other two of you feel about the future of country elevators and the extent to which the ICC has or has not or should or should not play a role in what actually happens to them in due course?

Mr. **Gregg**. Well, Mr. Taylor, on paper I am sure a railroad can put down for you every good economic reason why there should just be a few subterminals. You must remember that the real purpose of a country elevator is to serve his customers in that community, and if he is gone, Mr. Gans is right, we have feed plants in connection with some of our elevators, we have fertilizer, we are the sole supplier of their needs. You take away their ability to handle their grain at a profitable margin and give them service, you have taken away all the resources that man has to run his business. That is exactly what is going to happen if we are not terribly careful. I have heard railroad people say, well, there just is not any use for the country elevator anymore. Well, he has not been out of his office.

Mr. **Taylor**. Mr. Smith, how do you feel about it?

Mr. **Smith**. I am going to cop out and say that I concur with Joe here. He is right in it. Cargill operates a large country-elevator chain, and performs the same and similar services for the communities that we are involved in, and I concur with Joe.

Mr. **Taylor**. I just have one more question if I might, Senator, Mr. Gregg, your testimony does state that Staggers has allowed for the cancellation of joint rates and joint routes and it should be rescinded. Perhaps this is going over the same ground the Senator covered, but would it not perhaps be appropriate to allow those cancellations if in fact they were not anticompetitive? I know this presumes a responsible Commission, and I would love to have you come to Washington and talk to my colleagues.

Mr. **Gregg**. I bet you would. I am not sure they would.

Mr. **Taylor**. Assuming we had a Commission that was really going to deal with the problem—and we hope there are some more Commissioners coming. We are presently at four, and I have been waiting a long, long time and getting somewhat impatient as I am sure you are. But assuming the Commission would act, would that not be a much better answer than to just throw the whole thing out? Is that not throwing the baby out with the bath?

Mr. **Gregg**. That is probably very true. I look at it from Kansas City grain market. I know how important Kansas City grain market is for the exporting of hard wheat out of the United States. The way things are going, Mr. Taylor, we do not know what is going to happen to us next and we cannot have those cancellations in Kansas City, we absolutely cannot.

Senator **Kassebaum**. Thank you very much. I expect in all fairness we need to get the railroad's rebuttal and see if indeed a case can be made. I very much appreciate your testimony.

Mr. **Gregg**. Thank you very much.

Senator **Kassebaum**. Now, this is the last panel, so everyone else who are witnesses, if you would please come. It is a pleasure to welcome this next panel discussion. On this side we will start with the grain elevator representatives. I do now know that this is the order. Let me just give the names as I have them here. Duane Morford, Lorraine Grain, Fuel and Stock; T. R. Henrickson, Logan

Grain Co.; John W. Severe, Western Grain; Sherman Baird, Garden City Co-op; Gary Runnalls, Bertrand Elevators, Inc. On the other side Jack Colvin, senior assistant vice president, market development, Unon Pacific Railroad, Missouri Pacific Railroad; Tom Steiniger, vice president of marketing, MKT and OKT Railroads; D. R. Finley, manager of grain traffic development, Santa Fe Railroad. It is a pleasure to welcome all of you, very much appreciate your being here. I might suggest perhaps that in fairness of balance we let representatives of the railroads start first in their testimony. Mr. Colvin, start with you.

STATEMENTS OF J. R. COLVIN, SENIOR ASSISTANT VICE PRESIDENT, MARKET DEVELOPMENT, UNION PACIFIC AND MISSOURI PACIFIC RAILROADS; T. F. STEINIGER, VICE PRESIDENT, MARKETING, MISSOURI-KANSAS-TEXAS RAILROAD CO., AND OKLAHOMA, KANSAS & TEXAS RAILROAD CO.; DONALD R. FINLEY, MANAGER, GRAIN TRAFFIC DEVELOPMENT, ATCHISON, TOPEKA & SANTA FE RAILWAY CO.; SHERMAN BAIRD, GRAIN DIVISION MANAGER, GARDEN CITY CO-OP; GARY R. RUNNALLS, GENERAL MANAGER, BERTRAND ELEVATORS, INC.; TOLIFF R. HENRICKSON, LOGAN CO., INC.; DUANE MORFORD, GENERAL MANAGER, LORRAINE GRAIN, FUEL & STOCK CO.; AND JOHN SEVERE, VICE PRESIDENT AND GENERAL MANAGER, WESTERN GRAIN, INC.

Mr. Colvin. Senator Kassebaum. I am Jack Colvin, senior assistant ~~vice pre~~sident, market development, Union Pacific and Missouri Pacific Railroads. It is a pleasure indeed to appear before this committee. I have prepared a statement which I will submit for the record. In my prepared statement is a report of how we feel the merger of the UP and MP has benefited Kansas grain shippers.

We have been able to make a fleet of about 14,000 covered hopper cars available during the harvest period just concluded and we can rotate car supply geographically to meet harvest demand.

We have been able to move substantial quantities of wheat to the west coast for export. We can also move traffic from UP points to the gulf on a single line basis over our MP lines.

We are maintaining a rate structure that allows single-car shipments into terminals and provides incentives for terminal operators to move grain outbound in multiple-car and grainload shipments. This has accomplished two important things: First, the country elevator operator has been able to remain competitive without devoting the capital needed to gear up for multiple-car shipments; second, the terminal operator is given the incentive to purchase grain delivered by rail and subsequently ship it out in multiple-car units. The terminal operator can load out in volume and also meet specific quality requirements. Furthermore, it allows the country elevator to be a stronger force in the storage and transportation of grain in today's marketplace.

Let me now turn to the Staggers Rail Act and what we believe are its very positive implications for grain transportation.

The Staggers Rail Act has removed regulatory shackles which prevented the rail industy from competing on a more equal footing with our principal competitors, the barge and motor carrier industries. Simultaneously, the act has fostered more intensified railroad against railroad competition.

Coupled with the very heavy competition which arises with overcapacity—the recent transportation environment—the provisions of Staggers, especially those authorizing rail contracts, have prompted even more intramodel and intermodal competition.

There are grain shippers who argue they are captive to the railroad industry. In my opinion, given the grain transportation marketplace, there are no truly captive shippers. Kansas grain movement is a good example of what takes place. Trucks move freely throughout the State transporting grain to various railroad-served points, from the country elevator to rail terminals, and to terminals located on the Missouri River and to terminals on the Arkansas River in Oklahoma. Railroads compete vigorously with trucks for this grain business, which is generally short haul in nature, from the country elevator to the terminal. Additionally, each separate railroad serving elevators in Kansas must maintain a constant awareness of the competitive posture of its elevators vis-a-vis elevators served by competing railroads in Kansas, as well as in other regions of the country. In short, there is widespread competition today.

The marketplace is constantly changing, requiring flexible and responsive action in order to adapt to new circumstances. Our responsiveness to the grain industry has been strengthened by our ability to effect necessary rate adjustments in a timely manner. The changes in the Staggers Rail Act, including shortened statutory notice periods, have been essential.

While the great bulk of our Kansas grain moves under tariff provisions today, the Staggers Act has given us additional flexibility for dealing with unique marketing opportunities through contract arrangements. Rail contracts facilitate business deals and contract rates provide important benefits for the shipper and the farmer. Rail contracts serve to promote competition, both intramodally as well as intermodally.

Contracts allow the rail industry to tailor programs to specific shipper needs, address unique rate, service or equipment requirements, and provide for creativeness in the marketplace.

Rail contracts also permit a response to specific competitive situations as they arise.

Let me address the issue of contract term disclosure. I realize, Senator, during recent oversight hearings in Washington you expressed some concern over the issue of posting or disclosure of grain rates. We feel that the present ICC regulations which permit limited disclosure are in fact consistent with good public policy. The rail industry's competitors, truckers and water carriers, are not required to disclose their rates or other contract provisions.

There are other reasons for not modifying the present disclosure provisions. We believe that increased disclosure would interfere with the opportunity to fashion specialized transportation services for individual shippers, destroy volume and productivity considerations, and remove the incentive for both the carrier and the shipper to test innovations.

We also believe that greater disclosure of contract terms will weaken the intramodal, that is, rail against rail rate, and the competitive spirit which prevails today within our industry. Union Pacific System does not feel that any statutory changes regarding disclosure are necessary at this time.

In conclusion, we believe that Staggers Rail Act has provided many benefits and opportunities to the railroads and to the shippers. It has in fact fostered competition between all modes of transportation. It has forced us in the rail industry to become increasingly efficient in providing grain transportation services and utilizing equipment to the general benefit of Kansas shippers and farmers. Thank you.

[The statement follows:]

STATEMENT OF JOHN R. COLVIN, SENIOR ASSISTANT VICE PRESIDENT-MARKET DEVELOPMENT, UNION PACIFIC AND MISSOURI PACIFIC RAILROADS

I am Jack Colvin, Senior Assistant Vice President-Market Development, Union Pacific and Missouri Pacific Railroads. It is indeed a pleasure to appear before this Committee to present testimony of Union Pacific System's important role in the transportation of grain in the Kansas market.

I am particularly pleased that I can begin my testimony by reporting to you that, as a result of the merger of the Union Pacific and Missouri Pacific Railroads, many of the projected benefits of our combined system have already been realized during this first harvest season in which we have operated as the combined Union Pacific System. Of particular interest to our producers and shippers in Kansas has been a greater flexibility in equipment utilization—the ability of the combined system to maximize utilization of the covered hopper fleet in the transportation of grain. In effect, during the Kansas harvest, Union Pacific and Missouri Pacific grain hopper fleets were utilized interchangably by each line as if they were one fleet.

As the harvest season began in the southwest part of the United States, and moved progressively through Texas, Oklahoma, Kansas, Nebraska, and to the Northwestern states, we have been able to make a much larger car fleet available in each area during the harvest period by using both Missouri Pacific and Union Pacific grain equipment. The resulting and combined UP/MP grain fleets approximate some 14,000 covered hoppers.

That kind of equipment availability and flexibility has been particularly important in Kansas this year. Even going into the harvest, grain storage space was extremely tight. The combination of an excellent yielding crop, depressed export conditions on the Gulf and the extremely congested terminal structure required a substantial increase in covered happen to satisfy origin-loading requirements. Another favorable factor was the movement of substantial quantities of wheat to the west coast for export. This movement from western Kansas helped to keep equipment loading and moving an open destination, subsequently making our combined covered hopper fleet even more mobile. The merger has also allowed us to feed empty covered hoppers into Kanasas from both the east and west end of the state, thus providing operating effficiencies and cost savings.

In my opinion, the car supply of the Missouri Pacific and the Union Pacific during the current harvest season has been fully responsive to shipper needs. Although occasional spot shortages of equipment were experienced, we believe that the spot shortages were due not to equipment shortages but rather to delay at congested unloading points. Indeed, it was generally recognized even going into the harvest that the majority of the terminal areas were already at approximately 80 percent of capacity, and that it would not be possible to absorb in a short time sufficient quantities of grain to accommodate in all cases the timely cycling of grain equipment. Many of the large terminal elevators accumulated several hundred loaded cars obtained in the vicinity of, or en route to, their facilities. On the Union Pacific Kansas Division, for example, we experienced some days in which over 1,500 covered hoppers were idled, waiting to move to terminal elevators due to restricted unloading operations at the elevators. Similarly, on the Missouri Pacific, loads held between Wichita and Hutchinson approached 1,000 cars for several days. Yet, even with this problem, shippers who desired equipment for loading received, for the most part, equipment within 24 to 48 hours of time desired as a result of the use of the combined grain covered hopper fleet.

In addition to improvements in increased flexibility and the utilization of our equipment, we believe that the combined system and resulting efficiencies and flexibilities have allowed us to substantially reduce transportation costs to our shippers.

We have been able to effect substantial cost savings by maintaining a rate structure that allows for single-car shipments into the terminals and provides incentives for terminal operators to move grain outbound in multiple-car shipments. This has accomplished two important things: first, the country elevator operator has been able to remain competitive without devoting capital necessary to gear up for multiple-car shipments, and second, the terminal operator has been given an incentive to purchase grain delivered by rail and subsequently ship it out in multiple-car units. This allows the terminal operator to load out not only in volume, but also to specific quality requirements. It also allows the country elevator to be a stronger force in the storage and transportation of grain in today's marketplace.

While the realized benefits of our merger are most gratifying to those of us on the Union Pacific System, I am sure that you are interested in our views of the impact of the Staggers Rail Act, and my remarks will now turn to that important issue.

The Staggers Rail Act was designed to remove many of the regulatory shackles which had for many years hindered the rail industry from competing on a more equal footing with our principal competitors, the barge and motor carrier industry. Simultaneously, the Staggers Rail Act fostered a more intensified intramodally competitive environment principally through restrictions in the railroads' antitrust immunity as well as through the mechanism of rail contracts.

During the nearly 3-year period since enactment of the Staggers Rail Act, I have witnessed more competition for haulage of our Nation's goods than in the three decades preceding the Staggers Rail Act. Of course, considerable competition resulted in part from the various transportation modes striving to retain market share during a period when the flow of goods was at depressed levels and transportation capacity was at excessive levels. Coupled with the normally intensified competition which arises in an overcapacity environment, the provisions of the Staggers Rail Act, especially those formalizing rail contracts, prompted even more intramodal and intermodal competition.

Notwithstanding the extremely high level of competition which permeates the transportation industry today, there remain some shippers who argue they are captive to the railroad industry. In my opinion, as long as there are various modes of transportation, there will not be any so-called "captive shippers," and the State of Kansas is a good example of the modern competitive transportation market-place. Trucks move freely throughout the State, transporting grain from one railroad served point to another, from the country elevator to rail terminals, to terminals located on the Missouri River as well as to terminals on the Arkansas River in Oklahoma. Railroads compete vigorously with trucks for this grain business, which is generally short haul in nature, from the country elevator to the terminal. Additionally, each separate railroad serving elevators in Kansas must maintain a constant awareness of the competitive posture of elevators served by the railroad vis-a-vis cross country elevators served by competing railroads. Notwithstanding many elevators are served by a single railroad, we fully recognize the fact those elevators must compete for grain against other elevators not served by the same railroad. Hence, there remains very strong intramodal competition for Kansas grain.

One of the important transitions that we have seen in the rail transportation sector has been from the boxcar to the covered hopper for the movement of grain. That change began in the early 1970's and was completed by the late 1970's. Today, the only meaningful shipments of grain by boxcars are to Mexico, but that, too, has been steadily declining. The advent of the covered hopper brought about a relatively specialized piece of equipment ideally designed for the movement of grain. Its capacity is 75 percent greater than the boxcar, yet moves with greater ease and mobility and is far more efficient for the railroads. In addition, the covered hopper is far less labor-intensive in loading and unloading, giving benefits to the elevators. By virtue of an increased payload, carriers have been able to provide cost savings to shippers through lower transportation charges. We have also been able to operate grain trains, which are basically large blocks of covered hoppers destined to a common point. These grain trains receive expedited handling to destination for unloading and are subsequently brought back to an area for reloading. The transit time is often only half that of regular service, therefore providing for increased equipment utilization and subsequently increasing the available car supply. Through the efficiencies obtained with the heavy payload of the covered hopper car and trainload handling of grain, the railroads are able to compete in markets which otherwise would be lost to truck or barge.

The marketplace is a constantly changing environment that requires flexible and responsive action in order to adapt to those circustances which define our business environment. The changes in the Staggers Rail Act, including shortened statutory notice periods, have certainly been helpful in dealing with many of these changes.

Our responsiveness to the grain industry has been accelerated by our ability to effect necessary rate adjustments in a timely manner. While the great bulk of our Kansas grain moves under tariff provisions, the Staggers Rail Act has given us additional flexibility for dealing with unique marketing opportunities primarily through contractual arrangements. Rail contracts provide an extremely useful vehicle for transacting business deals—which might not otherwise be developed, or even work. Contract rates do provide important benefits. Contracts provide the mechanism through which the rail industry can tailor programs to specific shipper needs, address unique rate, service or equipment requirements, and thus provide for creativeness in the marketplace. Equally important is the fact that rail contracts permit the railroad industry to respond to specific competitive situations so they arise. There should be little doubt that rail contracts serve to promote competition, both intramodally and intermodally.

I think it appropriate at this time to direct my comments to an important aspect of the contract freedoms provided under the Staggers Rail Act, specifically the question of contract term disclosure. I have noted, Senator Kassebaum, that during recent oversight hearings held on the Staggers Rail Act in Washington, you expressed some concern over the issue of "posting" or disclosure of grain rates in order to permit greater public and shipper access to contract information. In our opinion, Senator, we feel that the present regulations, which permit limited disclosure of contract information, are consistent with the requirements of the Staggers Act itself and are not contrary to sound public transportation policy. Aside from the very significant fact that the rail industry's competitors are not required to disclose their contract rates or provisions, we believe that there are a number of other reasons which are critical in developing and maintaining a positive relationship between the rail shipper and carrier which suggests the importance of not modifying the present disclosure provisions. Increased disclosure would, we believe, interfere with the opportunity to deal with specific needs of the marketplace, would remove the provocation to consider unique ideas or opportunities in fashioning individual transportation service, destroy volume and productivity considerations and, indeed, would only destroy the incentive for both carrier and shipper to promote creative innovations and ideas in today's competitive marketplace. Additionally, we feel greater disclosure of contract terms will materially weaken the intramodally competitive spirit which prevails today among railroads because we railroaders know from experience that any creative step made by one railroad to capture a given segment of business will often be frustrated by the action of other railroads to mitigate that action. In short, the Union Pacific does not believe that any changes regarding disclosure are necessary at this time.

Clearly, the Staggers Rail Act has provided many benefits and opportunities to the shipper. It has created intense competition between all modes of transportation. Such competition has forced us in the rail industry—as I suspect it has in other competing modes—to become increasingly efficient in providing transportation services and utilizing equipment.

Thank you for the opportunity to participate today, and I will now be pleased to respond to your questions.

Senator **Kassebaum**. Thank you, Mr. Colvin. Mr. Steiniger.

Mr. **Steiniger**. My name is T. F. Steiniger, I am vice President, marketing of Missouri-Kansas-Texas Railroad Co. and Oklahoma, Kansas and Texas Railroad Co. I am very happy to have the chance to appear before the subcommittee, and I wish to thank the members of the subcommittee for this opportunity.

Since passage of the Staggers Rail Act of 1980, railroad transportation contracts have become very important to the MKT and the OKT. Our experience with contracts has on the whole enabled us to retain traffic in the face of increased competition from other railroads and other modes of transportation and to attract additional traffic. Nowhere is this more apparent than with the movement of grain. Since October of 1980, MKT and OKT have entered into a substantial number of grain transportation contracts with both small and large shippers.

At the present time we are satisfied with the manner in which section 208 of Staggers is being administered by the Interstate

Commerce Commission. We are not in favor of requiring more disclosure of contract information to the public than what is now required by the ICC. We are also most emphatically opposed to any attempt to remove the railroad's ability to contract for the transportation of grain. Either of these alternatives we believe would not be in the public interest.

We certainly are familiar with the problems of a small entity competing with much larger entities. MKT and OKT are relatively small rail carriers and must compete on a daily basis with much larger Class I railroads.

MKT and OKT have actively solicited grain transportation contracts with many small country elevators. Furthermore, we have been very successful in negotiating contracts with those small country elevators. We believe the availability and confidentiality of these contracts has enabled both the shippers and the railroads to have the necessary flexibility to negotiate mutually beneficial terms for the movement of grain.

We do not believe that elimination of contracts for the transportation of grain or the disclosure of additional contract information would solve either our competitive problems or small shippers' competitive problems. In our view, the much more serious competitive problem for the MKT–OKT and smaller shippers is the nonavailability of competitive rail alternatives. That is, the wholesale elimination of joint routes and rates that has taken place has resulted in a reduction in rail competition. The wholesale cancellation by certain rail carriers and the failure of the ICC to preserve the joint routes and rates has eliminated the shippers' choice of selecting routing, the result is that carriers such as MKT no longer have the ability to compete with the merged carrier for the grain traffic.

In our view, the joint route and rate cancellations that have occurred are contrary to what Congress intended when it passed the Staggers Act.

The legislation being proposed by the group known as Railroads Against Monopoly, RAM, is a very reasonable approach to the problem. The proposed legislation would require the establishment of joint routes and rates in circumstances where the joint route and rate would enable the carrier with a competing single line route to earn comparable revenue. Also, the proposal would require the ICC to act in certain circumstances to preserve or establish joint routes and rates.

In summary, contracts have enabled both the smaller grain shippers and carriers to have the needed flexibility to compete with the larger shippers and carriers. MKT and OKT are firm supporters of rail contracts and believe they are an important part of our ability to survive in the future. The problem of joint route and rate cancellation is of much greater concern, and we urge Congress to take the necessary steps to maintain the present system of joint routes and rates.

Let me again thank the subcommittee for the invitation to appear here today. Before I conclude my statements, though, Senator, from the standpoint of the MKT and OKT, I had the opportunity of listening to Governor Carlin and his remarks with regards to railroad abandonment and those remarks in turn echoed by Congressman Glickman. I would like to say at this time, of course with your assistance, the OKT was formed and produced an additional 170 miles of railroad that once was abandoned. Thank you.

[The statement follows:]

STATEMENT OF T. F. STEINIGER, VICE PRESIDENT, MARKETING, MISSOURI-KANSAS-TEXAS RAILROAD AND OKLAHOMA, KANSAS & TEXAS RAILROAD

My name is T. F. Steiniger and I am Vice President-Marketing of Missouri-Kansas-Texas Railroad Co. [MKT] and Oklahoma, Kansas & Texas Railroad Co. [OKT]. I am very happy to have the chance to appear before the Subcommittee and I wish to thank the members of the Subcommittee for this opportunity.

I understand that the focus of this hearing is on railroad transportation contracts and in particular, the effect of such contracts on grain shippers. Since passage of the Staggers Rail Act of 1980 (Staggers), railroad transportation contracts have become very important to the MKT and OKT. Our experience with contracts has, on the whole, enabled us to retain traffic in the face of increased competition from other railroads and other modes of transportation and to attract additional traffic. Nowhere is this more apparent than with the movement of grain. Since October 1980, MKT and OKT have entered into a substantial number of grain transportation contracts with both small and large shippers.

At the present time, we are satisfied with the manner in which section 208 of Staggers (49 U.S.C. 10713) is being administered by the Interstate Commerce Commission [ICC]. We are not in favor of requiring more disclosure of contract information to the public than what is now required by the ICC. We are also most emphatically opposed to any attempt to remove the railroads' ability to contract for the transportation of grain. Either of these alternatives, we believe, would not be in the public interest.

We understand that some of the smaller grain shippers believe that rail transportation contracts have eliminated their ability to compete with the large shippers. We certainly are familiar with the problems of a small entity competing with much larger entities. MKT and OKT are relatively small rail carriers and must compete on a daily basis with much larger Class I rail carriers. I am sure we have many of the same concerns about maintaining our ability to compete as do these smaller shippers. We are essentially facing the same type of problem.

As a matter of fact, MKT and OKT have actively solicited grain transportation contracts with small country elevators. Furthermore, we have been very successful in negotiating contracts with those small country elevators. We believe the availability and confidentiality of these contracts has enabled both the shippers and the railroads to have the necessary flexibility to negotiate mutually beneficial terms for the movement of grain. Without the availability and confidentiality, it is very unlikely that we would have been able to tailor packages to meet the individual transportation needs of these smaller shippers.

We do not believe that elimination of contracts for the transportation of grain or the disclosure of additional contract information would solve either our competitive problems or small shippers' competitive problems. In our view, the much more serious competitive problem for the MKT, OKT, and smaller grain shippers is the non-availability of competitive rail alternatives. That is, the wholesale elimination of joint routes and rates that has taken place has resulted in a reduction in rail competition. In most cases, a small shipper is physically located and served by only one rail carrier. Often that carrier also serves the destination to which the shipper is moving its traffic. In the past, the ICC has required that serving carrier to maintain joint routes and rates with other rail carriers, in addition to its single line route and rate, so that the shipper would have more than one choice in routing his traffic. Now, however, the wholesale cancellations by certain rail carriers and the failure of the ICC to preserve the joint routes and rates has eliminated the shippers' choice of selecting routing.

The problem now is that the recent rail mergers which have taken place in the past few years have created large rail systems which serve not only the grain origins but also the destination areas. These large systems now have the ability to provide single line service from the origin to the final destination, which is often a port such as Houston, for export. Previously, if the carrier before the merger served only the origin, it would have had joint routes with carriers serving only the destination. Now, however, the merged carrier has the incentive to cancel these joint routes and rates so that it will receive its longest haul and most revenue via the remaining single line route.

The result is that carriers such as MKT no longer have the ability to compete with the merged carrier for the grain traffic. Likewise, the shipper physically located on and served only by the merged carrier, will have no other rail alternative than to use the merged carrier's single line system. That is true even if the previously available joint route was less costly and more efficient than the remaining single line route. In other words, a reduction of rail competition takes place and the shipper loses its competitive rail alternatives.

In our view, the joint route and rate cancellations that have occurred are contrary to what Congress intended when it passed the Staggers Act. One of the goals of the Staggers Act was to promote intramodal (between rail carriers) competition. However, the joint route and rate cancellations have done just the opposite. By eliminating the opportunity of carriers such as MKT to compete through joint routes and rates, the effect has been to seriously reduce intramodal competition in many areas. It is very difficult to see how the ICC can believe that eliminating competitors from the marketplace enhances competition.

This is especially true since many of the joint route and rate cancellations were not coupled with reduced rates on the remaining single line routes. The fact is that when most of the joint route cancellations were made effective, the shipper did not and has not seen any benefit at all in the form of lower rates. Rather, the shipper has only seen his competitive choices reduced. The result has merely been a transfer of revenue from carriers such as MKT to the larger merged systems with no corresponding public benefit.

Unfortunately, the ICC has failed to really address the problems of joint route and rate cancellations. MKT and other carriers, on several occasions, have protested joint route and rate cancellations. The ICC, in virtually every instance, failed to suspend the protested cancellations Further, the ICC has refused to investigate, even though the cancellations were very far reaching. The ICC evidently needs additional instruction from Congress in this area as to the need to preserve joint routes and rates. The U.S. Court of Appeals for the Seventh Circuit apparently also believes the ICC has not fully considered the impact of joint rate and route cancellations. Recently the Court remanded for further consideration, an ICC decision approving massive Conrail joint route cancellations.

The actions of these large carriers in eliminating joint routes and rates threatens the existence of the national rail system as we know it today. It is an undeniable fact that the national rail system is based on the existence of joint routes and rates. We urge Congress to take the necessary steps to insure that the system remains intact. Without a system of joint routes and rates, the shippers physically served by only one carrier will simply have no rail competitive options.

What then is the solution? We do not profess to have all of the answers. The problem is to balance the legitimate goal of eliminating inefficient routings while maintaining efficient rail service alternatives. One solution might very well be to amend the Interstate Commerce Act to require the maintenance of joint routes and rates in certain circumstances. The legislation proposed by the group known as Railroads Against Monopoly [RAM] is a very reasonable approach to the problem. That proposal was made in July of this year to the Senate oversight hearings on the Staggers Act and is entitled the Rail Competition Act of 1983.

The proposed legislation would require the establishment of joint routes and rates in circumstances where the joint route and rate would enable the carrier with a competing single line route to earn comparable revenue. Also, the proposal would require the ICC to act in certain circumstances to preserve or establish joint routes and rates. A copy of the proposed legislation is attached to my statement. Rather than repeat what was said at the oversight hearings, I would ask that the subcommittee please take note of the testimony at that hearing relating to the proposed legislation.

In closing, please let me reiterate that we believe the problem of small grain shippers in today's regulatory environment is not the existence of rail transportation contracts. Rather, it is the diminishing rail competition that results from the elimination of joint routes and rates. Contracts have enabled both the smaller grain shippers and carriers to have the needed flexibility to compete with the larger shippers and carriers. MKT is a firm supporter of rail contracts and believes they are an important part of our ability to survive in the future. The problem of joint route and rate cancellations is of much greater concern and we urge the Congress to take the necessary steps to maintain the present system of joint routes and rates.

Let me again thank the subcommittee for the invitation to appear here today. I would now be happy to answer any questions the Subcommittee may have.

Senator KASSEBAUM. Thank you, Mr. Steiniger. Mr. Finley.

Mr. **Finley**. Thank you. My name is Don Finley, I am manager of grain traffic development, Santa Fe Railway. Before I enter into my comments, I would like to thank you for the opportunity of being here and also to make the comment that I am sure the country elevators that we serve wish that they had loyal farmers such as Mike Gans, and there is no question that I am sure our country elevator operators that we serve wish that they were all as loyal as Joe Gregg. But that is not the real world, Senator, and the real world that is going on has not necessarily contributed to the Staggers Act.

Since the passage of the Staggers Act, we have entered into over 100 contracts covering transportation of grain and grain products with over 90 contracts in effect today. We are currently in negotiations with another 15 to 20 contracts and constantly initiate new discussions or new contracts or revisions of existing contracts if those marketing conditions change. We have filed over 400 amendments to the contracts that we have to meet these changing conditions. We have contracts with the large international trading and export companies, cooperatives, medium-sized companies and small firms, including country elevators. They cover both movements from terminal points to the gulf as well as inbound movement from the thousands of country elevators we serve. We have always considered our country elevators our life's blood. We do not want just a few terminal elevators. We stand ready at any time to negotiate a contract with any shipper of grain and grain products for an appropriate price service package to meet both of our needs.

One of the concerns voiced by shippers with respect to the contracts is that the public does not have complete access to all the terms. I recognize that these are difficult contracts because each party wants to keep their information confidential but wants to know what is available to their competitors. There are rules under which contracts can be challenged to which we have no objection. From a marketing standpoint, I can understand why some grain shippers advocate complete contract disclosure.

First, complete disclosure may inhibit competition among grain merchandisers; second, and most important, the merchandiser has historically used the public rail rate as an index for pricing grain from the farmer-producer who pays the most transportation charges to the prevailing market. However, it does not always move rail, even though it is purchased on that price.

Parties in favor of complete disclosure fail to point out that either they nor the modes of transportation we compete with are obligated to disclose any terms whatsoever with respect to the transportation or purchasing of grain. If, as these parties claim, complete contract disclosure is necessary for their survival, then I submit that logically disclosure of all contracts concerning grain, whether it be for rail, motor carrier, barge or even those contracts covering the sale of grain, would accomplish those goals even better. But to require only the railroads to operate in a competitive vacuum while our direct competitors and their customers continue to shroud their business practices in secrecy is totally unfair.

Insofar as Santa Fe is concerned, we have treated every single firm we deal with fairly and equitably. We always have and will continue to do our utmost to keep our grain shippers competitive in the marketplace. If our shippers lose their business, we lose revenues also.

From our standpoint, we are concerned that the rules be uniform for all parties involved. We are in the middle of conflicting interests. Again, every shipper wants to know what their competitors have, but they insist that their provisions be kept confidential in the contracts.

Part of the question of whether greater disclosure of contract information should be made available is whether that information would really make any difference to smaller elevator operators in the grain marketplace. Our contracts are not limited to large companies or to movements from terminal elevators. We have contracts with small country elevators, again, our lifeblood, and most of our whole grain contracts expressly include movements from these country elevators to terminals throughout our service territory. If an individual elevator operator is uneasy that the grain company to whom he sells his grain is not fully disclosing to him the basis upon which grain transportation contracts affect the price he is receiving, that matter is outside our control. The practices of purchasing grain are part of the overall context of business relationships between those country elevators and the exporters and cooperatives with whom they deal.

In summation, I believe the Staggers Act contracting provisions have been of great benefit to both the railroads and the grain industry, and we jointly must be permitted gain further experience in this area before any changes should be made in the basic framework for contracting.

In general, I believe the transportation marketplace for grain and grain products is highly competitive. We face competition not only from other railroads at or near the stations we serve, but also from the totally unregulated trucks and barges. And I submit that the rail market of dominance in grain is totally nonexistent.

In the area of reciprocal switching, switching carriers should be adequately compensated for their services while providing full access on a reasonable basis. If anything, the Staggers Act provided a new and additional remedy to deal with problems in the switching area which are only beginning to be explored. Many of the developments in this area or the related areas of joint rates appear to stem more from a general change in regulatory climate and economic conditions then specific statutory changes.

Santa Fe is basically pleased with the Staggers Act and believes further legislative change at this time would be totally inappropriate. While the rail industry has yet to achieve an adequate financial posture, we believe that permitting us to work more like other private sector companies directly with our customers will be to our mutual benefit.

Again, I thank you for being here. I will be happy to answer any questions.

[The statement follows:]

STATEMENT OF DONALD R. FINLEY

My name is Donald R. Finley, Manager-Grain Traffic Development for the Atchison, Topeka & Santa Fe Railway Co. [Santa Fe]. I have worked for Santa Fe since 1950 in various capacities, and have been in my present position for over seven years. I am constantly in personal contact with the shippers of agricultural commodities (grain) throughout Santa Fe's entire Western and Southwestern territories, and hope my experiences with grain transportation both prior and subsequent to the Staggers Rail Act of 1980 will be of some value in this hearing.

I would like to say at the outset that Santa Fe commends the extensive review of the Staggers Act by Congress. Like any other legislation respecting the commerce area, the Staggers Act has had diverse effects on shippers and rail carriers. However, as a general statement, Santa Fe believes that the Staggers Act is a large step in the right direction.

One must remember that the purpose of the Staggers Act was to balance the needs of the railroads with those of the shipping public, to the maximum extent possible letting competition regulate the industry. Another major purpose of the act was to insure a financially sound rail system, a goal which regulation prior to the passage of the act had clearly not achieved. I believe those goals, if achieved, will benefit the public generally and that any attempt at this time to reopen the Staggers Act to undermine its basic purposes would be a serious mistake.

Because the major thrust of this particular hearing is to review grain transportation under the act, with particular emphasis on contracting practices, most of my comments are directed towards and deal with the Santa Fe's experiences regarding the contract transportation of agricultural commodities, especially grain. I will then briefly comment upon other areas which have been the subject of concern by various shippers.

DISCLOSURE OF RAILROAD TRANSPORTATION CONTRACT TERMS

Since the passage of the Staggers Act, Santa Fe has entered into over 100 contracts covering the transportation of grain or grain products with over 90 in effect at present. We are currently in negotiations for another 15 to 20 contracts, and are constantly initiating new discussions for new contracts or revisions of existing contracts.

We have entered into contracts with all kinds and sizes of firms in the grain business. We have contracts with the large international trading and export companies, cooperatives, medium-sized grain merchandisers, and small country elevators which cover both movements from terminal points to the Gulf for export and inbound gathering movements from thousands of country elevators. We also have contract with flour millers. We endeavor to provide the price-service package that our shippers need and can utilize. Through volume commitments and train size commitments we are permitted to plan for better efficiency to the benefit of ourselves and the shippers we serve. We stand ready at any time to negotiate a contract with any shipper of grain products for an appropriate price-service package to meet both our needs.

I understand one of the main concerns voiced by some shippers with respect to the contract transportation of grain is that the public does not have complete access to all the terms of railroad transportation contracts. I recognize that there are difficult conflicts here between each party's desire to keep its own business affairs confidential and to have full access to the terms available to other companies, particularly its competitors.

Section 10713 of the Interstate Commerce Act and the final contract rules prescribed by the Interstate Commerce Commission in Ex Parte 387, *Railroad Transportation Contracts*, served November 4, 1982, (49 C.F.R. § 1039 and 1300) enable the shipper to determine the basic parameters of railroad transportation contracts that may affect it. Under ICC rules, upon the filing of a contract covering the transportation of agricultural commodities, a public contract summary must be filed disclosing: (1) names of the participating carriers; (2) the involved commodities; (3) the origins and destinations; (4) the contract's duration; (5) rail care data; (6) base rates for charges, movement types, minimum annual volumes, rate escalation provisions; and (7) the existence and identification of any other special features. Except for contracts covering forest products, in no other area are the railroads required to disclose such detailed contracting information to the general public.

After reviewing this information, any grain shipper which feels it will be individually harmed by such contract may file a complaint with the ICC. If the shipper is able to demonstrate that the involved has refused to enter into a similar agreement with it, the ICC has indicated that such shipper will be provided with access to additional contract information.

The Commission had said to the grain firms in effect, "Okay, if you are willing to make a similar commitment for transportation on similar terms, show me you have attempted to negotiate accordingly and if the rail carrier has not negotiated in good faith I will show you the details." The Commission also then has the power to disapprove a contract if a carrier is unwilling to enter into a similar agreement with another affected shipper.

From a marketing standpoint, I can understand why some grain shippers advocate complete contract disclosure. First, complete disclosure may inhibit competition among grain merchandisers by lessening the incentive to seek more advantageous terms that you know your competitor will become aware of and seek himself. Second, and perhaps most important, the merchandiser has historically used the public rail rate as an index for purchasing grain from the farmer-producer who pays the transportation charges to the prevailing market.

With this public and basically stabilized rail rate, the grain merchandiser will be able to shop among truck, and barge lines, and perhaps even other rail carriers, for a better deal. The merchandiser or grain shipper advocating full disclosure could not care less if the shipment ever moved by rail. While the farmer-producer would absorb the full transportation charges to market based upon this "public" rail rate, the merchandiser would be pocketing the difference between the public rail rate and the actual transportation charges negotiated in a "secret" deal between such merchandiser and the trucking or barge line.

The parties in favor of the complete disclosure of grain/rail contracts conveniently fail to point out that neither they nor the modes of transportation Santa Fe must compete with are obligated to disclose any terms whatsoever with respect to the transportation or purchasing of grain. If, as these parties claim, complete contract disclosure is necessary for their survival, then I submit that logically the disclosure of all private contracts concerning grain, that is, those for motor carrier transportation, barge transportation, and for the purchase and sale of grain, would accomplish those goals even better. But to require only the railroads to operate in a competitive vacuum, while the railroads' direct competitors and their customers continue to shroud their business practices in secrecy, is totally inequitable. I also note that in my opinion if railroad transportation contracts covering the movement of agricultural commodities are subject to complete disclosure, contracts would hardly ever be entered into.

Insofar as Santa Fe is concerned, we have treated every single firm with which we deal fairly. When a shipper contacts Santa Fe with regard to negotiating a contract rail rate which is equitable to the shipper and compensatory to the railroad, we do our utmost to keep such shipper competitive in the marketplace. Santa Fe always has and will continue to do its utmost to keep the grain shippers located on its lines competitive in the marketplace. For if such shippers lose their business, Santa Fe's revenues will suffer also.

From Santa Fe's standpoint, we are concerned that the rules be uniform for all parties involved. We find ourselves somewhat in the middle of the conflicting interests of our shippers. Every shipper would like to know the terms of everyone else's railroad transportation contract. By the same token, every shipper with whom we have negotiated a railroad transportation contract wants its own affairs kept strictly confidential and requests or insists upon our agreement to maintain that confidentiality.

Part of the question of whether greater disclosure of contract information should be made available is whether that information would really make any difference to smaller elevator operators in the grain marketplace. As I described earlier, Santa Fe's railroad transportation contracts on grain and grain products are not limited to large companies or to movements from terminal elevators. We have contracts with small country elevators, and most of our whole grain contracts expressly include movements from small country elevators throughout our service territory. If an individual elevator operator may be uneasy that the grain company or cooperative (of which he is a member) to whom he sells his grain is not fully disclosing to him the basis upon which grain transportation contracts affect the price he is receiving for his grain, that is a matter outside our control. The practices in purchasing grain are part of the overall context of business relationships between those country elevators and the exporters and cooperatives with whom they deal.

I believe the existing statutory framework permits the Commission, after monitoring the progress of railroad transportation contracts, to determine if in particular instances the disclosure of more or less information would be appropriate and correspondingly revise its rules, but that no modification to the Staggers Act itself is necessary to deal with this concern.

OTHER AREAS OF CONCERN BROUGHT ABOUT BY THE STAGGERS ACT

Although I understand this hearing is intended to focus primarily upon the contract transportation of grain, shippers have also expressed their concerns over various other areas of the Staggers Act. I would like to address briefly some of these matters insofar as they pertain to grain transportation.

Some shippers have expressed their displeasure at being subject to the "market dominance" of the railroads serving them, and that the ICC is ignoring their plight. Such allegations are completely without merit. There is not a single grain origin on any of Santa Fe's lines, no matter how remote, where Santa Fe is able to exercise any form of monopoly power.

At each and every rail origin there are innumerable numbers of truck operators attempting to secure new traffic. Commonsense tells one that if rail rates reach too great a level, the traffic will be lost to a lower cost transportation service. The completely unregulated truckers are constantly soliciting traffic from rail origins with the highest rates, regardless of location. These truckers work independently and buy and sell their service to the marketplace. They can truck direct to ultimate destination or cross country to a competing railroad. Therefore, contrary to the testimony submitted in prior hearings, there are many buyers and sellers of transportation at every grain origination station in the U.S., and even direct from the farm. There is also the constant potential loss to cross country rail served points.

If there is any real market power in the grain marketplace, it is in the grain merchandisers themselves. They hold the power as to what is to move, the mode used, as well as when and to where. All transportation is subject to their needs or desires. In many transactions, I believe the grain merchandisers can make more profit by negotiating a lower freight rate than on the sale of the grain itself.

Turning to another subject, Santa Fe has always been a strong supporter of joint line rates. Historically we have attempted to establish as many joint line rates via as many junctions as was economically feasible. We have granted both short haul and long haul routes—relying on service factors to maximize our revenues. We likewise believe that cancellation of joint routes in given instances can harm shippers and other carriers.

However, rail carriers should not be required to maintain any route or service when the revenue obtained is below the cost of performing such functions, and should not be required to establish or maintain joint rates that are inefficient, outmoded, or overly duplicative. Shippers do not sell without a profit, nor are they forced or need to ship to every market. The railroads should not be forced to subsidize any entities in the marketplace.

Various groups have also complained that they receive inadequate notice of rail rate changes, and that contracts should not be able to take effect upon filing with the ICC. Here again, it was not merely the railroads which sought more expeditious procedures, but also the grain shippers themselves.

Grain sale prices fluctuate constantly. Truck and barge transportation rates are subject to change without notice. The Staggers Act and subsequent ICC regulations permitting contracts to being on the date of filing (49 C.F.R. §1039.2) merely place the railroads on an equal footing with their competitors.

Prior to the promulgation of 49 C.F.R. §1039.2, Santa Fe had to forego new, and also lost existing traffic while waiting 30 days for contract rates to take effect. In fact, this 30-day notice period was so adverse to the grain shippers' interests, that Santa Fe was constantly filing, at shippers' requests, petitions for exemption from this notice period to permit contracts to go into effect more quickly. However, this petition procedure was burdensome and costly to all parties involved, including the ICC. Furthermore, elimination of the 30-day notice period has not taken away any remedies afforded a disadvantaged shipper by Congress.

It has been alleged that grain-moving railroads intentionally discriminate against certain types of shippers. I again emphasize that Santa Fe treats all its customers on a non-discriminatory basis whether by tariff or contract. However, if and when discriminatory pricing were to surface, both the overall transportation environment and existing provisions of the Interstate Commerce Act are available to remedy it.

Intramodal and intermodal competition in existence today are strong deterrents to discriminatory pricing. If a rail carrier treats a customer unfairly, either in its contract practices or by tariff publications, trucks and to somewhat lesser extent other railroads or barges, are immediately there to solicit the traffic. In the very few instances where a shipper may truly be captive to one rail carrier, sections 10713(d)(2)(B) and 10741 of the Commerce Act provide a party with the ability via the ICC to remedy any unlawful discriminatory practices.

Another major area in which concern has recently been expressed is that of reciprocal switching. With respect to grain shipments, this concern is two-pronged. First, shippers seek the continued availability of reciprocal switching, and second, such switching should be performed at reasonable rates. These are critical concerns in the orderly marketing of grain, especially in the wheat growing areas. To have an orderly marketing system, the flow from farm to country elevator to the terminal elevators, thence to the consuming marketplace, must be a smooth one.

Santa Fe believes that the availability of reciprocal switching at reasonable rates benefits both shippers and carriers. The recent controversies in this area do not appear to me to be a result of any specific changes in sections of the Staggers Act, but rather are a product of broader changes in the transportation industry. If anything, the Staggers Act itself increased the remedies available to deal with problems relating to reciprocal switching.

In summation, I believe the Staggers Act is a valuable piece of legislation for both shippers and common carriers. Santa Fe is basically pleased with the Staggers Act and sees no need for legislative change at this time. While the Staggers Act has yet to result in a financially stronger national rail transportation system, this is probably primarily due to the current and recent economic climate. It would be premature to make changes in this legislation, which represented an effort to fundamentally reform the transportation marketplace, without further experience of both shippers and rail carriers in adapting to a new more competitive environment.

Senator KASSEBAUM. Thank you. All three of you have testified to the fact that you believe the current means of dealing with contracts are beneficial and fair and necessary for your own competitive outlook as well as being of benefit to the shippers. Is that not correct? I would like to ask, one, why you think that a full disclosure of a contract would indeed weaken the relationship of competition and interfere? Why is it of such benefit and why would it indeed cause severe problems?

Mr. FINLEY. It is my opinion that if we have full disclosure of contracts, there will be no more contracts. It is simply they are long, time-consuming negotiations working out package deals, and if you're going to expose the contract, you might as well put it in the tariff. There would just in my opinion not be any contracts, and there are areas that contracts need to be for both the benefit of the people we serve as well as ourselves.

Senator KASSEBAUM. Well, you commented, Mr. Finley, that is trucks and barges had to do this as well, as you put it, do you believe that if they had to handle contracts in this same method, then it would be beneficial or do you see again the same thing happening, that contracts simply then would not become a factor?

Mr. FINLEY. We are willing to operate under the same parameters and conditions as our competitors. If the full information of their contracts are revealed and ours were revealed, we are operating competitively, but we have to have the ability to react to the marketplace. We just cannot operate in a vacuum with them able to change rates overnight, to pick and choose whatever traffic they want. We do not want to pick and choose. We want to handle everything that is available, but we have to make a profit, otherwise we are going to have nationalization of railroads. It is just imperative that we have freedom in the marketplace to compete with our competitors.

Senator KASSEBAUM. If it happens to the railroads, it will happen quite a few other places as well.

Mr. FINLEY. Yes.

Senator KASSEBAUM. I do not think that is a prime worry at this point in time. But I do think that we have to answer some of the questions that have been raised here this morning. Obviously it causes great concern. One of the worries is, as I am sure you are well aware and very well illustrated by Mr. Gans' case, I think, and I would like to have any of you comment on this, the fact that a railroad will enter into a contract with a great advantage to one elevator in an effort to perhaps force another out of service, not intentionally, but it being to the best interests at the time for the railroad, but ultimately leading them to a real monopoly of the railroad in that area, and once the smaller operator is out, for instance, that has not been a party, such as Bennington, to an advantageous contract, then it would give the railroad real power to do whatever they wanted to, and indeed you would have captive shippers at that point. As you know, this is a worry. How would you answer that in the case that we heard illustrated earlier?

Mr. FINLEY. While in passing, I would just like to say I am unable to find any captive shipper on the Santa Fe.

Mr. STEINIGER. You know, Senator, from a standpoint of the OKT-MKT, especially with regards to the captive shipper situation, as you know, Senator, with your assistance and with the great State of Kansas' assistance, for many people it was this assistance that allowed the MKT to formulate the final arrangements to bring the OKT onstream. Of course those were the abandoned Rock Island lines. Now, along that line those are all small country elevators. So when we envisioned taking over that line, we envisioned that we would serve the small country elevators. We have done so, and I am proud to state as I look at some of the friendly faces in the audience this morning that here in Kansas of all the total transportation grain contracts we have, 50 percent are from Kansas shippers. So I might add that this has been a vehicle and tool for the OKT-MKT. It certainly has. It has allowed us as a smaller carrier to sit down with a small elevator and negotiate a contract that was beneficial for his firm, beneficial for us.

Senator KASSEBAUM. Mr. Steiniger, if I may, you commented that you felt contracts had been of benefit to the shipper. Could you expand on that just a minute and say how you feel that it has affected the delivered price of grain?

Mr. STEINIGER. Well, from our standpoint, with regards to the benefit of the shipper, obviously to be able to sit down and to contract on mutually acceptable terms the movement of grain from an area—and I may point out as an example, actually one system in particular of grain that used to move via truck barge, now, this particular grain—I use this just as one example—did not move in this particular State, it moved in an adjoining State, but at that particular time elevators on the MKT throughout the State of Missouri were losing their grain share or their market share to truck-barge. We were able to put together several contracts with elevators on MKT in that particular portion of the State. We are moving that grain today via rail-barge, so it gave us the competitive edge and, obviously, allowed a lucrative basis of grain rates for the country elevator. These are all small elevators that I am referring to.

The same has occurred with regards to the OKT side. As I mentioned, the ability of sitting down in shirt sleeves on a one-on-one negotiation with a country elevator operator, working out a deal that has been good for him, it is one that, obviously, has returned a profit to his elevator and one that has returned a profit to the railroad and, obviously, has helped us on a revenue side with maintaining the Oklahoma, Kansas and Texas Railroad. So I do not see this.

Once again, speaking on behalf of the OKT–MKT, it has been a vital tool for us. In fact, it becomes even more vital when I take a look at the fact that what we really have to deal with from the standpoint of the MKT–OKT is route and rate cancellations. This has really given us much more concern.

I might point out that in June 1981, there was a mega-carrier that had at that particular time put in a scale of rates, a single-line basis and obviously that single-line basis has eliminated the MKT–OKT. Later on, in March 1983, the same mega-carrier had done the same thing with the domestic scale of grain rates, also eliminating the MKT.

One of the most important and particular points I would like to bring out on the reciprocal switching side, since it was mentioned this morning, the unique character of the railroad that is serving a particular industry as a switching carrier from the standpoint that he is providing a service, the power and the crew, what has happened, for instance, with regards to elimination of our joint route is this particular carrier now tenders that movement to us at destination in which we perform only a switch haul. Keeping in mind the fact that as we switch that particular industry, we used to enjoy the road haul revenues. Obviously, now we enjoy the minimum of the switching charge. We look back and see that over the years and historically those industries were built with rail assistance, either commercially or from a standpoint of even looking at the total market operations of locational sites for these particular industries. Because of the unique character of single-line routes, those single-line routes are eliminating us from serving our own shippers on a road haul basis. I believe that is our real problem.

Senator **Kassebaum**. I would guess all three of you would not agree on rate cancellations. But I would like to ask you, since you mentioned that as you believe one of the real factors that we need to contend with in grain transportation is the joint rate cancellation, what would be your solution? I mean would you feel——

Mr. **Steiniger**. The solution I suggested, of course, was this particular Rail Competition Act of 1983. I referred to this RAM group and this particular section-by-section analysis that I have here before me without going through all the details. Basically, what it would provide is that the joint routes would be provided for, and in providing this type of operation, there would be an independent rate authority under which the railroad whose joint rate had been effectively canceled or made noncompetitive would have the automatic concurrence of the railroad that took such initiative of a publication of a competing joint line rate with the existing division percentages, so long as a joint route is shorter than the single-line route or the initiating railroad receives from a competing joint line rate a revenue to the variable cost ratio not lower than the lowest revenue to variable cost ratio it receives on its other single line.

Now, I have detailed for me several sections analyzing this particular Rail Competition Act. To say that this would be the final bill, perhaps it needs refinement and fine tuning, but I would say that the principle is the same, and that is we are not in favor of keeping all routes and those that we consider inefficient, but I would remind the Commission that with regards, for instance, to one of the protests and some of the protests that have been denied, we have indicated in those joint route and rate cancellations that we even had a shorter route, which obviously was even more fuel efficient, and yet we were denied a joint route. So what we are saying today, obviously we are not getting what we consider due process under the law as it is today.

Senator **KASSEBAUM**. Thank you. Chairman Taylor.

Mr. **TAYLOR**. Could I just follow up on that quickly? If the Commission took a greater concern with your problem, do you think that would obviate the need for legislation or do you think the legislation is required regardless of how the Commission responds to that particular problem? Are you just a little sour of what has happened here in the last several months?

Mr. **STEINIGER**. It is more important than that, Mr. Chairman. In fact, I was sitting in the audience when you made your remark. I guess I would have to refer even to your remark that if we felt that we were dealing before a reasonable Commission or these protests instead of being summarily dismissed were given an analysis, a thorough analysis and we would be rendered a fair handling, I think that would be one thing. But in view of the fact that the track record says that this apparently is not so, that allows us to take a look at other means, and obviously that would be additional legislation.

Mr. **TAYLOR**. But you might not be so anxious for the additional legislation if you really felt you had the Commission addressing your concerns?

Mr. **STEINIGER**. I would say that there would be much merit in that. I certainly would not waive my opportunity of still looking at additional legislation, as I mentioned, because I am fearful that those decisions that have been rendered which have been ineffective for us and obviously devastating in certain areas put us in a fearful position. And the reason I say this, it is not from the standpoint, once again, of maintaining inefficient routings. I am talking about maintaining the efficient routes that these people here—and I have heard this morning from the grain shippers and the small country elevators—to make sure that they can maintain what was given to them under part 1 of the act; that is, the right to route their traffic. I believe that this is what would do it, either the effective handling of the present protest under the Commission or, as I said before, in view of the fact that that has failed, to take a look at additional legislation to insure that we have the joint rates and routes.

Mr. **TAYLOR**. I cannot comment on your legislation because I have not had a chance really to review it. This is the first time we have seen it.

I would like to go back, if I might, Senator, to the question you raised since I did not really hear a complete and full answer to it. Mr. Finley raised the point about the fact that there should be full disclosure for barge and truck as well as rail. I think we ought to remember we are just talking about agricultural commodities now. We are not talking about any other kinds of contracts, because they are the ones about which the Congress felt there was some particular concern related to discrimination or destructive practices. All other shippers were only concerned about the common carrier obligation problem. I do not think there is any problem with those rules; at least I do not know of any. We have not heard a lot of static about them. We are really only talking about agricultural or forest products contracts to start off with, I think, and that is important to keep in mind. Your point was that if you wound up with full disclosure, and I am talking about, say, 60 days after execution—I understand the importance of the negotiations and how that should be kept secret. If that whole process is revealed and gone into and done out in the open, so to speak, you are probably right, there would not be any contracts. But if it was restricted to the agriculture and forest products contracts, and if it was not done until, let's say, 60 days after the execution date—and remembering, too, that the court may well come along and require a disclosure of the actual rates rather than just the base rate discussions, so you may have to be doing that anyway, even under the present statute. I would ask all three of you: Under those circumstances, do you all feel and do you all agree that full disclosure of the contracts against that kind of a backdrop, if we also applied it to water and motor carriers so that you are on equal footing with them would result in no more contracting at all?

Mr. COLVIN. On behalf of the Union Pacific and Missouri Pacific, we would feel far more comfortable with full disclosure by all modes. We would certainly be then on a more equal footing to compete in the marketplace. However, there is also some concern on my part personally that disclosure at any time would probably lead to, at least, a lessening of the intramodal competitive spirit that prevails today. I question whether any railroad would want to be viewed as the low bidder in a highly competitive situation and revealed as the low bidder at some marginal prices which, of course, has benefited the entire State of Kansas and its farmers. There is also fear of the obvious onslaught of shipper requests that would emanate from literally everywhere for like treatment, notwithstanding circumstances that may be entirely different. Those would be my concerns. But in any event, getting back to the initial part of the question, we would feel much more comfortable with full disclosure on the part of all modes.

Mr. TAYLOR. If you had that, do you think that really, as was indicated by Mr. Finley, would be the end of contracting if that was done and if it applied to all modes?

Mr. COLVIN. I think it would.

Mr. TAYLOR. Even though you may well be required to disclose the rates in terms of the court's interpretation of where we are under the present statute?

Mr. COLVIN. I think it would end the contract form of ratemaking.

Mr. TAYLOR. Well, I certainly do not agree that that should happen. I think the contracting is terribly important. That is why I was very concerned about your answers. How about the other two witnesses?

Mr. STEINIGER. With regards to the MKT-OKT, I believe you made mention earlier, Mr. Chairman, a suggestion with regard to perhaps holding it in abeyance for 60 days as confidential and revealing the confidentiality of that contract at that time. Is that correct?

Mr. **Taylor**. That's correct.

Mr. **Steiniger**. It would seem to me that once again perhaps this would lead to maybe short-term contracts, 30- or 60-day contracts, but I would have to echo the remarks of Mr. Finley and Mr. Colvin that once full disclosure is made, I think you jeopardize the business opportunities with regards to the particular movement. With regards to answer, I guess, part two of your question regarding the other modes of transportation, theoretically if all modes of transportation were treated on an equal basis and having full disclosure, there is a possibility then it would be placed on equal terms, I would agree. But once again, I think you have emasculated then the very business purpose of the contract, that is to sit down on a one-to-one negotiation and to remove the additional business that now is either moving by a competitive mode intramodally or intermodally. So as the MKT-OKT—as we struggle out there for every piece of traffic that we can get, the full disclosure of contracts would be most detrimental to us.

Senator **Kassebaum**. Thank you very much. Now we will hear from the—oh, pardon me, Mr. Finley. Time is up.

Mr. **Finley**. Just to reiterate what—I totally agree with that. It would be the end of contracting, and I also would have to admit would make my job easier, but it would be the total end of contracts. I agree with the comment made that if it was 60 days, all you would see would be a continual filing of 30-day contracts.

Senator **Kassebaum**. Thank you very much. Now, we will hear from the elevator operators and would be anxious as you give your statements to reflect on what indeed happened with the end of contracts would be the effect on your business.

Mr. **Baird**. Senator Kassebaum and committee members, my name is Sherman Baird, I am 59 years of age and for the past 25 years have been employed as grain division manager of the Garden City Co-op, an agricultural cooperative of some 2,300 producer members located in Garden City, Kans. I have been engaged in the management of cooperative elevators for the last 35 years. I manage eight elevator facilities for the Garden City Co-op, which have a total storage capacity of 7.5 million bushels. Six of the facilities are located on the Santa Fe Railroad and two are located on the Garden City Western Railway Co., a short-line railroad operating with interline connections available with the Santa Fe only at Garden City, Kans.

We have been striving in an attempt to keep our facilities competitive with terminal and subterminal elevators within the State of Kansas as a result of apparent contract rates being granted to terminal and subterminal operators.

It is now apparent that a contract has been granted to a new facility located at Colby, Kans., and the effect of same is now being felt within the area of our historic origination territory. I can report to this committee that the Garden City Co-op has not been successful in meeting a competitive bid structure. Consider these apparent contracts, the results are obvious that country elevators like ours have lost grain to terminals and subterminals, and carriers needing continued business with serving small facilities likewise have lost traffic to other competitive rail carriers or truck mode.

It is extremely difficult for me to quantify the amount of grain that has been diverted from our area in southwest Kansas to other geographic areas of the State. Like Salina and Colby where our grain has historically not moved, discussion with Santa Fe railroad personnel have indicated that the Sante Fe, the principal carrier in southwest Kansas, has lost an estimated 8 to 10 million bushels of grain to terminals that have particularly advantageous contract rates. This is grain which normally would have been handled and merchandised by country elevator facilities located in southwest Kansas served by the Santa Fe.

Losses in Finney and portions of Scott County, which is north of Finney County, are estimated to be between 1.75 and 2 million bushels annually. This estimate is based upon the percentage decrease in the countrywide production that our facility handled in 1982 compared with 1981. It is not accurate to base any comparison solely upon the total number of bushels handled as that figure may increase or decrease depending upon many factors including crop yield, increased use of fertilizer, weather, and other related matters.

Based upon percentages of crop produced and handled, I can advise that the Garden City Co-op facilities in 1980 handled approximately 50 percent of the total production in Finney County. That figure increased to 57 percent in the production in 1981. However, with the implementation of advantages rate contracts in late 1981 and all of 1982, our percentage from the crop production decreased 16 percentage points down to 41 percent in 1982. The 1983 figures are not available. However, we are convinced and concerned that the 1982 trend is continuing. And since that time we have found, based on our volume of grain we received in 1983, our percent of receipts are down 33 percent from a crop that is supposed to be the second largest crop in Kansas' history.

We submit that the primary explanation for these dramatic reductions are a direct result of contracts being implemented only to terminal facilities, thereby granting same an unbelievable drawing power through freight differentials inherent to transportation contracts are maintained on a confidential basis by both the participating shipper and the contracting railroad, it appears that these rates contracted are substantially less than those available in published tarriffs. While I do have general overall knowledge of the actual freight differentials that exist between available published tariffs applicable from Garden City, Kans., and contract rates available to terminals and subterminal operators, I do have specific knowledge which I would like to explain as to differentials that do exist between contract rates and a published tariff rate.

In October of 1982 our cooperative facilities shipped grain on a single car published point-to-point tariff rate of $1.18 per hundredweight from Pierceville, Kans., to Wellington, Kans., via the Sante Fe. The grain was shipped for storage into the terminal facility at Wellington and was later sold to that terminal in May of 1983. Our cooperative paid the inbound freight to the terminal based upon the published tariff rate of $1.18.

Inadvertently, the accounting department of the railroad sent us freight bills for payment of freight charges on the aforementioned movement rather than to the terminal operator. We therefore assumed the terminal operator had a transportation contract rate with the railroad on an inbound basis with some type of a volume attached. Since the actual freight rate charged on this move by the carrier was 58 cents per hundredweight or 60 cents per hundred weight less than the published rates, this granted the terminal facility 60 cents per hundredweight additional margin on that grain.

This transportation cost my facility $1.18, but the railroad charged the terminal only 58 cents. As you can see, the difference is phenomenal with the contract rate being 51-percent less than the published tariff rate. I defy the railroad or anyone else to justify such a difference on the basis of economics of scale or particular efficiencies achieved by contract rates. The simple fact of the matter is that the railroad is willing to move the grain for one customer for 58 cents and not grant another customer the same privilege.

In this example, however, there appears to be no cost efficiency to the railroad based upon volume into the facility. The transportation provided was for a single car and no unit train was involved. No efficiency was created for fast handling equipment. The simple fact of the matter is that it costs a country elevator more. The spread or differential between these charges for identical and substantially similar move is what is destroying rail movement from country elevator locations and forcing larger draw territories via inbound truck mode for terminal operators.

Contract rate provisions have resulted in unbelievable differences between published tariffs and contract rate. In the example that I have given, the difference of over 51 percent is, in my estimation, unjustifiable and is evidence that railroads can simply use contracts selectively.

In addition to creating rather substantial disparities between published rates and contract rates and even in some instances by permitting such great disparities in published rates, the Staggers Act of 1980 is, in my opinion, directly responsible for another unjustifiable discriminatory rate practice. Although the Staggers Act supposedly prohibits peak, seasonal, or demand-sensitive rates, for the last 3 years in a row we have lost approximately $100,000 because of numerous adjustments and rate changes and/or contracts made shortly after peak seasonal movements.

In order to make room for harvest each year, we will ship grain to terminal locations with transit privileges. This requires grain which moved into the terminal to move out of the terminal facility on the same railroad. Prior to Staggers the rate in effect on the date of shipment was used exclusively. When the rate increased after the date of shipment but before the date of the outbound move, the increase had no effect, the outbound move was still based upon the cheaper rate in effect from the date of shipment. Since Staggers, the railroad has instituted transit rate policy that gives it the best of both worlds. The freight rate is determined from the date of the shipment of the grain but only where that rate is greater than the freight rate in effect at the time of the sale and outbound movement. Where the freight rate at the time of the sale and outbound move exceeds the freight rate at the time of shipment, the rate at the time of sale and outbound move, which is the greater rate, is the one used. In short, the railroad now gets all the advantages of freight increases and none of the disadvantages of freight decreases.

For the last 3 years running, which coincides with the enactment of the Staggers Act, these transit rates have been decreased immediately after we have moved grain to terminal for transit storage to make room in our facilities for harvest. Once the grain is moved from transit storage, we are locked into a particular market via a particular railroad. This rate policy really places a financial burden on a country elevator. As we are left with no alternative but to absorb the additional freight out of the profit margin that was anticipated for handling the grain, it really hurts when that additional freight costs you, the shipper, over $100,000. It means no profit at all. To pass the freight increase on to the producer is a guaranteed way to lose a customer, and under Staggers there is no apparent relief available for this practice.

The gross disparity between the contract rates and published rates have operated to grant contracting shippers an unfair competitive advantage over shippers without contracts. While competition previously was based solely upon which grain merchants would give up more margin, it is now based upon one grain merchant giving up all of his margin and the other simply giving up a part of his freight savings and making full margin. This is not competition. I urge you, the committee and Congress, to listen to us, to study the problem and to enact remedial legislation to correct these inequities. We do not want a subsidy, we do not want guaranteed economic survival. We simply want the opportunity to compete or to start out even with the competition and not 60 cents in the hole. We thank you for the opportunity to appear before this committee.

[The statement follows:]

STATEMENT OF SHERMAN BAIRD ON BEHALF OF GARDEN CITY CO-OP, INC. AND KANSAS GRAIN AND FEED DEALERS ASSOCIATION

Senator Kassebaum and committee members: My name is Sherman Baird. I am 59 years old and for the past 20 years have been employed as Grain Division Manager of the Garden City Co-Op, Inc., an agricultural cooperative of some 2,300 producer-members located in Garden City, Kansas. I have been engaged in the management of cooperative elevators for the last 35 years. I manage eight elevator facilities for the Garden City Co-Op which have a total storage capacity of 7.5 million bushels. I consider all of our facilities to be "captive shippers". Six of the facilities are located on the Santa Fe; and two are located on a shortline railroad, the Garden City & Western Railroad Co. The only interline available to the GCW is the Santa Fe at Garden City.

I have been fighting to keep my facilities competitive against contract rates in effect at terminal facilities in Salina, Kansas, for about the last year to year and a half. This last year, I think an advantageous contract has been given to a new facility in Colby, Kans., and the draw of this contract is now being felt as well. I can report to this committee that I have not been too successful in meeting the competition, nor have many other elevators located in southwest central, northwest, and north central Kansas. Not only have country elevators like mine lost grain to a terminal that has a contract rate in effect, but railroads that serve those facilities have likewise lost grain traffic to other railroads that they otherwise would have moved.

It is extremely difficult for me to quantify the amount of grain that has been diverted from our trade area in southwest Kansas to other geographic areas of the State, like Salina, where our grain has not historically moved and would not move, but for the existence of the contract rate. I have had discussions with Santa Fe Railroad personnel in which they have indicated to me that the Santa Fe, the principal carrier in southwest Kansas, lost a total of between 8 and 10 million bushels of grain to a terminal in Salina that had a particularly advantageous contract rate. This is grain that normally would have been handled and merchandised by country elevator facilities located in southwest Kansas that are served by the Santa Fe.

I estimate the loss in Finney County and part of Scott County, Kans., to be between 1.75 and 2 million bushels of grain. I base my estimate upon the percentage decrease in the county wide *production that my facilities* handled in 1982 and compared with 1981. It is not accurate to base any comparison upon the total number of bushels handled as that figure may increase or decrease depending upon crop yield, increase use of fertilizer, weather and other matters. Based upon percentages of produced crop handled, I can tell you that Garden City Co-Op facilities in 1980 handled approximately 50 percent of the total production in Finney County. In 1981, that figure increased to 57 percent of the production. However, with the implementation of a rail contract in late 1981 and all of 1982 in Salina, our percentage of grain handled from the crop production in 1982 decreased 16 percentage points down to 41 percent in 1982. I don't have 1983 figures yet; but I am concerned that the 1982 trend is continuing.

I submit to you that the principal explanation for this rather dramatic reduction in percentage of grain handled by my facilities is the implementation of contract rates at these terminal facilities and the almost unbelievable drawing power that is created by the freight differential inherent in such contracts, which operate like a vacuum to suck grain from my trade area. While the actual contract rates are kept secret by the participating shipper and contracting railroad, these rates must be substantially less than the published tariffs available to me to justify a truck haul of something in excess of 150 miles that costs the producer about 25 cents per bushel.

While I do not have knowledge of the actual freight differential that exists between the published tariffs available to me in Garden City and the contract rate available to the terminals in Salina, I do have specific knowledge of what kind of difference exists between a contract rate and a published tariff for an identical point-to-point move. That difference is phenomenal; the contract rate is 51 percent less than the published tariff.

In October 1982, my facility shipped grain on a single-car published point-to-point tariff rate of $1.18 per hundred weight from Pierceville to Wellington, Kans., via the Santa Fe. The grain was shipped to a terminal facility in Wellington for storage, and later sold to that terminal facility in May 1983. My cooperative paid the inbound freight based upon the published tariff of $1.18.

Quite by accident, the accounting department of the railroad sent us bills of lading on the grain that were intended to be sent to the terminal facility. I suspect the terminal had a contract rate with the railroad for in-bound freight; I assume on some type of a volume basis. The actual freight rate charged on the move by the railroad was 58 cents per hundredweight. My cooperative had to pay in 60 cents more per hundredweight for the identical move. This gave the terminal facility 60 cents per hundredweight as additional margin on that grain. The move cost my facility $1.18; but the railroad charged the terminal only 58 cents.

I defy the railroad or anyone else to justify such a fantastic difference on the basis of economies of scale or particular efficiencies achieved by contract rates which I hear so much about. The simple fact of the matter is that the railroad is willing to move the grain for one customer for 58 cents; but charges another customer $1.18 for the same move. I am told under traditional antitrust analysis, such a pricing practice for goods would constitute discriminatory pricing, unless the difference is somehow justifiable on the basis of volume.

In this example, however, there was no cost efficiency to the railroad based upon volume into the facility. The move was point-to-point for a single car. No unit train was involved. There was no efficiency created by fast handling equipment. The simple fact of the matter is that it cost a country elevator $1.18 for a move that cost a terminal only 58 cents. The spread or differential between these charges for identical or substantially similar moves is why it is destroying competition in the grain industry.

Apparently, the railroad is using the advantageous paid-in freight rate to the terminal as a means of locking in out-bound traffic. Since the terminal in Wellington is served by another rail carrier, this railroad, to get the terminal's commitment to use it on all out-bound moves instead of the competing road, granted the terminal a very special "good deal"; on the in-bound move. Under Staggers, railroads are using contracts to keep traffic off other lines; they are willing to make this kind of a concession to "buy" traffic.

While a railroad has incentive to buy and lock in traffic where competition from another railroad is a factor, it has no such incentive when it comes to setting rates for captive shippers—the traffic is already locked in. Published tariffs available to my facilities were not lowered in an effort to meet the competition caused by terminal contracts until the summer of 1982. And even when these rates were lowered, they reflect the fact that the railroad has market dominance in the area. For instance, my facility at Wolf, Kans., is approximately 16 miles northwest of Garden City. Wolf is served by the GCW, the shortline, which must negotiate a division with the Santa Fe on the traffic delivered at Garden City. The published tariff at Wolf is $1.33 per hundredweight. We have another facility at Tennis, Kansas, some 16 miles north of Garden City. The published tariff from that location is 89 cent per hundredweight—with the railroad actually having to incur the expense to haul it the additional 16 miles. Apparently, this is simply what happens when a facility is captive to shortline railroad operation, which is in turn captive to a large carrier—a substantial freight difference that does not appear to be justifiable.

In addition to creating the rather substantial disparities between published rates and contract rates, and even in some instances by permitting such great disparities in published rates, the Staggers Rail Act of 1980 is in my opinion directly responsible for another unjustifiable discriminatory rate practice. While the Staggers Act supposedly provides for ICC review of peak, seasonal or demand sensitive rates, for the last three years in a row, we have lost approximately $100,000 because of rate changes made shortly after peak seasonal movements.

In order to make room for harvest each year, we will ship grain to terminal locations, with transit privileges. This locks the grain in for a move out of the terminal facility on the same railroad. Prior to Staggers, the rate in effect on the date of shipment was used exclusively. When the rate increased (the rate never decreased), after the date of shipment, but before the date of the out-bound move, the increase had no effect—the out-bound move was still based upon the cheaper tariff effect on the date of shipment.

Since Staggers, the railroad has instituted the transit rate policy that gives it the best of both worlds. The freight rate is determined from the date of the shipment of the grain, but only where that rate is greater than the freight rate in effect at the time of the sale and out-bound move. Where the freight rate at the time of the sale and out-bound move exceeds the freight rate at the time of shipment, the rate at the time of sale and out-bound move (the greater rate) is the one used. In short, the railroad now gets all of the advantages of freight increases; and none of the disadvantages of a freight decrease.

For the last 3 years running, which coincides with the enactment of Staggers, these transit rates have been decreased immediately after we've moved grain to terminals for transit storage to make room in our facilities for harvest. Once the grain has been moved for transit storage, we are locked into a particular market via a particular railroad. This rate policy really puts the squeeze on the country elevator. We are left with no alternative but to absorb the additional freight out of the profit margin that you hope you would have in the grain. It really hurts when that additional freight cost you, the shipper, over $100,000. It means no profit at all. To pass the freight increase on to the producer is a guaranteed way to lose a customer. And under Staggers, there is no apparent relief available for this practice.

In summary, I consider the impact of the Staggers Rail Act of 1980 to be disastrous—primarily because of the gross and unjustifiable disparity between available published tariffs and contract rates that the contract rate provision has fostered. One would think that my cooperative, which has an aggregate storage capacity of 7.5 million bushels and handles a similar amount of grain each year would be a likely candidate to have a contract rate. However, our facilities are captive to a single railroad. That railroad, but for the competition of another road's contract rate, will get the traffic any way. I have been told that the philosophy of the railroads is not to have a contract with any facility other than an export house—ostensibly for the reason that the exporter is the only shipper that has destination as well as a point of origin. By granting such a concession on the origin end, the carrier may obtain or "buy" more traffic statewide for the destination end than would otherwise be shipped on its lines.

The contract rate provision has resulted in unbelievable differences between published tariffs and the contract rate. In the example I gave, the difference of over 51 percent is in my estimation unjustifiable and is evidence that railroads are simply using contacts to buy traffic.

The gross disparity between the contract rates and published rates have operated to grant contracting shippers an unfair competitive advantage over shippers without contracts. While competition used to be based solely upon which grain merchant would give up more margin, it is now based upon one grain merchant giving up all of his margin and the other simply giving up a part of his freight savings and making full margins. This isn't competition, it is more like a grant of monopoly power.

In addition, railroads have instituted certain rate policies since Staggers that are totally unfair and aptly demonstrate the imbalance of bargaining power and market dominance enjoyed by railroads.

I urge you, your committee and Congress to listen to us; to study the problem; and to enact remedical legislation to correct these inequities. We don't want a subsidy. We don't want guaranteed economic survival. We simply want the opportunity to compete; to start out even with the competition—not 60 cent behind it because some railroad wants to buy traffic.

Senator **KASSEBAUM**. Thank you, Mr. Baird. Mr. Runnalls.

Mr. **RUNNALLS**. Senator Kassebaum, my name is Gary C. Runnalls, I live in Monument, Kans., and am the manager of Bertrand Elevators, Inc., which owns and operates a 1 million bushel capacity in Monument, Kans., and a 338,000 bushel capacity country elevator in McAllaster, Kans. Both elevators are located in Logan County, Kans., and are served solely by the Union Pacific Railroad. I have heard some testimony and read articles about captive shippers. I consider the elevators that I manage to be captive shippers. They are captive because the only rail service available is from the Union Pacific. And the rate available is whatever the Union Pacific publishes. I do not consider trucks to be a real alternative to rail transportation.

The Bertrand elevators that I manage are what I would consider full service country elevators. We store and merchandise grain; sell feed, seed, fertilizer, salt, chemicals, and general merchandise and have facilities to roll, dry and clean and treat grain. The bulk of our business is based upon our storage and handling of grain. Without that aspect of our business, we could not survive.

I want to make one point about the grain storage and grain merchandising aspect of our business. Both aspects are mutually dependent. Elevators in Kansas comprise 70 percent of the storage that is currently available in Kansas. A producer stores his grain in a facility like ours because he either has no, or lacks sufficient onfarm storage to handle his own grain; he wants to participate in a Federal program and needs a warehouse receipt; he wants to hold the grain until the price improves; and in harvest time, he simply wants to have a place to put grain. Without the ability to market the grain through the storage elevator, however a producer is not inclined to store the grain at a location where he can't market it from. To stay in business, a country elevator must therefore be able to both store and market grain effectively.

The elevators that I manage were competitive facilities prior to the Staggers Rail Act of 1980 becoming law. The paying price that an elevator could offer to producers was determined by the market price established by the Board of Trade less the freight required to get the grain to the market and less an allowance for profit to the elevator operator for handling the grain. Thus if the market price on the gulf on a particular day was $3.90 per bushel and the freight rate to get it there was 75 cents per bushel and the elevator operator needs 15 cents a bushel to cover expenses and make a reasonable profit on handling the grain, he would offer producers a track price at his location of $3 per bushel. To a large extent, freight was a neutral factor in the marketing decision, although there was some differences due to location and carloading capabilities. The difference created by location simply reflected the fact that some locations were further from the gulf than others, and therefore paid a proportionately higher freight rate. This difference did not affect competitiveness because of an offsetting cost. Producers would have to pay for trucks to haul grain to an elevator closer to the market. Additionally, the differences created by efficiency of operation or parlaying capabilities are determined by each elevator owner. If you wanted the better rate, you simply invested in your physical plant to make it more efficient to obtain the benefit of any freight differential available.

The Staggers Rail Act of 1980 authorized railroads and shippers to enter into contracts to set freight rates. In January of 1983 the Union Pacific Railroad entered into a contract with a new type of elevator facility in Colby, Kans. While I do not know what ths contract rate is, I firmly believe that it has operated to unfairly discriminate against the elevator facilities that I manage and others like mine. My opinion is based upon the facts that the contract rate is secret, that multiple car rates previously available to other shippers, which are also based upon efficiencies of operation, are no longer available to our facility, and the rate differential granted by the contract must be so great that it cannot be justified on the basis of efficiencies of operation or volume.

First, prior to the Staggers, all freight rates were public knowledge and took the form of published tariffs. Under those tariffs, the freight difference between a move to the gulf on the Union Pacific from Monument, Kans., and Colby, Kans., was approximately one half to 1 cent a bushel. My freight rate at Monument was about a cent higher to reflect the fact that I was 22 miles further out on the Union Pacific from the gulf.

Also, multiple car and volume-based freight rates were part of the published tariff system prior to Staggers. The Union Pacific had published freight rates based upon single car and multiple car moves. The rate for multiple car moves was lower. This policy encouraged shippers to upgrade their facilities to realize the freight savings. Based upon the existence of these multiple car rates, we invested $75,000 in our facility at Monument to get a 25-car loading capability. Under the published tariffs in effect at that time, we were able to save about 10 cents a bushel on a rate based on a 25-car move. We were willing to make this type of an investment because it made us more competitive. The decision was ours, no one else's.

I cannot tell you what freight rate the Union Pacific has given to the new Colby facility by contract. Because of the substantial difference in paying price that the Colby facility is able to offer compared to my paying prices, I suspect that the rate is about 20 cents a bushel or 33 cents a hundred less than what is available to other shippers in the area.

Let me give you an example of what differences there are in paying prices. The Colby facility was completed in December 1982 and started business in January 1983. On January 4 and 5, what I think are the first 2 days of operation, it opened with a paying price 14 cents a bushel greater than I was able to offer. By February 1983 the difference had increased to 17 cents. To get within 15 to 17 cents of their paying price, I had already cut my margin on grain by over 50 percent.

Let me give you some comparative figures on the freight rates that are included in the Union Pacific's published tariffs as a point of reference for you. The present Union Pacific tariff publishes freight rates available at Monument and Colby, Kans., based on 5-, 25- and 50-car rates. Even though I told you our facility at Monument has a 25-car loading capability, the Union Pacific does not make that rate available to us for direct shipments to the gulf because we are not a terminal location. The best rate I can get is a 5-car direct shipment to the gulf. The 25-car rate is not available to me.

Senator, I would like to use some of the charts that are prepared in my prepared testimony to show, I think, the difference in the ratres between my facility and the Colby facility are not totally justifiable by reason of location or cost savings due to efficiency of operation. First, I have a point of origin freight rate comparison that shows a difference in rates between Monument and Colby on the 5,- 25- and 50-car rates that presently are published by the Union Pacific. As you can see, there is a consistent difference of a cent a hundredweight or six-tenths of a cent a bushel due to location. This difference is justifiable on the basis of location. Monument is 22 miles further out on the branch line. The difference has always been in the rate structure and no one is complaining about it. Second, I have a multiple car rate chart that compares the cost savings in the published tariff between the 5-, 25- and 50-car rate that the Union Pacific has in effect at Monument. Remember, I cannot move cars directly to the gulf on the 25-car rate because the wording of the tariff does not permit it. However, the Union Pacific is willing to say by publishing the tariff that it will move 25 cars for 10 cents a bushel less than 5 cars. Also, that rate shows that a 50-car move can be done for about 3 cents a bushel less than a 25-car move. The rates must reflect the railroad's measure of cost savings in higher multiple car moves. Although a 75-car rate is not published, I have extended on the chart that it might be using the same proportional decrease that is shown between 25- and 50-car rates.

For purposes of argument, let us assume that I am right about what the Union Pacific's 75-car rate would be, and that is 70.7 cents a bushel to 71.7 cents per bushel as shown on the chart, less 1 cent a bushel distance differential at Colby. Since my facility has a 25-car loading capability, I should be entitled to the rate that is justified by my efficiency of operation, which under the published tariff is 76.2 cents a bushel for a 25-car loading capability. If this were true, the facility at Colby would be getting a total of 5½ cents a bushel break on the freight rate, a cent a bushel difference because it is 22 miles closer and 4½ cents because of the efficiency involved.

I submit to you that if the difference in rates available to my facility and the one at Colby were 5½ cents per bushel, the gross disparity in paying price would not be present. My conclusion is that the contract rate in effect is not based nor justifiable on the basis of efficiencies of operation.

Since Staggers, as interpreted by the Interstate Commerce Commission, authorizes contract rates to be kept secret, I am left in a position of playing blindman's bluff to compete against this rate. How much do I cut my margin? How long can I incur a loss to try to remain competitive? I cannot effectively challenge the contract rate before the Interstate Commerce Commission. The Commission through its regulations has determined that everything about the contract should be kept secret except the name of the carrier, the commodity involved and the length of the haul. How can you challenge such a rate if you do not know what it is?

Furthermore, while the Staggers Act provided that contract rates could be effective on a 30-day notice to permit shippers to object, the ICC has now permitted these rates to become effective on 1 day's notice. I think this simply reflects the Commission's determination that no one can challenge the rates because they do not know what they are or who they involve so why even provide for a time period to file objections?

Additionally, I have been advised by ICC counsel that unless I can show that the Union Pacific has market dominance over my facilities, the ICC will not even hear a challenge of the reasonableness of the rate. The fact that Union Pacific is the only railroad serving me, I am told, does not satisfy the test of market dominance, therefore it is unlikely that I could get before the Commission to challenge the reasonableness of whatever difference exists between my rate and the rate at Colby.

Second, I have been told that I would probably have the burden of proof to show that the contract rate is unreasonable. There are a series of formulas that determine who has the burden of proof, and I understand that in almost any circumstances imaginable, the shipper will always bear the burden of proving that rate is unreasonable, even though he does not have the necessary information.

Under the circumstances, I do not know what I can do. We have made a $75,000 investment to get a 25-car loading capability, but currently that rate is not available to me. The facility that I manage is not being rewarded for the level of effeciency that it has obtained, but there is little doubt that the Colby facility is. I submit that the existence of the contract rate provisions in Staggers encourages that kind of situation.

Under the circumstances, I certainly cannot justify any additional capital improvement to my facility to make it more efficient when I cannot realize the benefit of the level of efficiency I have presently obtained. Even if we could afford to file a complaint with the Interstate Commerce Commission, given the Commission's bias for total deregulation, I have been told by counsel that we do not have a proverbial prayer's chance in hell of success.

I had the counsel for the Kansas Grain and Feed Dealers Association contact the Railroad Contract Rate Advisory Service of the Interstate Commerce Commission for me to see what I could do about my situation. I have been informed that the Director of the Service at the Interstate Commerce Commission told our counsel that there was nothing that could be done but that we might try calling the Transportation Section Chief of the Antitrust Division of the Department of Justice because it did not sound like this type of situation should be permitted.

About a month ago I read an article in the Farm Bureau News about this new facility in Colby. The manager of it said that they did have bargain rail rates and they expected to pull wheat, milo, and corn from southwestern Nebraska, eastern Colorado and southwestern Kansas. The article also reported that the facility had to move about 40 unit trains a year, which is a volume of approximately 10 million bushels of grain.

With this kind of annual volume requirement, it is apparent that this facility with its contract rate will have an impact that will be felt for many miles around. I feel it very strongly just 22 miles away. In all of 1981, the total wheat production in Thomas and the four surrounding counties, Rawlins, Sheridan, Sherman and Logan, were only 13,452,300 bushels. If a facility like the one at Colby has a freight rate that can control a 10-million bushel annual volume, every country elevator in the five-county area can simply fold its tent and go home.

I have no quarrel with this difference in freight rate that can be justified by some cost savings that is achieved by efficiencies of operation. What I am against is a freight differential that is secret, that is not justified on the basis of direct cost savings obtained by efficiency of operation, that is employed to buy rail traffic and promote unfair competition. On the facts of my example, if the Union Pacific would simply publish a 75-car rate, that facility in Colby could have that rate, I could have my 25-car rate, and if the differential between the 25-car and 75-car rate was greater than in the example I have given in this statement, but nonetheless justifiable on the basis of direct cost savings due to efficiency, than I would have a decision to make, either to make an additional investment to get the better freight rate or learn to live with the differential. Right now I do not know what the differential is and I can only guess. We have made improvements in our facility to get the efficiency of operation, but we can't get a rate that recognizes the efficiency we have.

Since I am at wits' end about what to do to remain competitive or to challenge the situation, I am glad I have had this opportunity to testify here today so that I can ask you what can we do. Thank you.

[The statement follows:]

STATEMENT OF GARY C. RUNNALLS ON BEHALF OF BERTRAND ELEVATORS, INC., MONUMENT, KANS., AND KANSAS GRAIN AND FEED DEALERS ASSOCIATION

Senator Kassebaum and members of the committee: My name is Gary C. Runnalls. I live in Monument, Kans., and am Manager of Bertrand Elevators, Inc., which owns and operates a 1 million bushel capacity country elevator in Monument, Kansas, and a 338,000 bushel capacity country elevator in McAllaster, Kans. Both elevators are located in Logan County, Kans., and are served solely by the Union Pacific Railroad. I have heard some testimony and read articles about "captive shippers". I consider the elevators that I manage to be captive shippers. They are captive because the only rail service available is from the Union Pacific; and the rate available is whatever the Union Pacific publishes. I don't consider trucks to be a real alternative to rail transportation.

The Bertrand elevators that I manage are what I would consider "full service" country elevators. We store and merchandise grain, sell feed, seed, fertilizer, salt, chemicals and general merchandise; and have facilities to roll, dry, clean and treat grain. The bulk of our business is based upon our storage and handling of grain. Without that aspect of our business, we could not survive.

I want to make one point about the grain storage and grain merchandising aspect of our business. Both aspects are mutually dependent. Elevators in Kansas comprise 70 percent of the storage that is currently available in Kansas. A producer stores his grain in a facility like ours because he either has no, or lacks sufficient on-farm storage to handle his own grain; he wants to participate in a Federal program and needs a warehouse receipt; he wants to hold the grain until price improves; and in harvest time, he simply wants to have a place to put grain. Without the ability to market the grain through the storage elevator, however, a producer is not inclined to store the grain at a location where he can't market it from. To stay in business, a country elevator must therefore be able to both store and market grain effectively.

The elevators that I manage were competitive facilities prior to the Staggers Rail Act of 1980 becoming law. The paying price that an elevator could offer to producers was determined by the market price established by the Board of Trade, less the freight required to get the grain to the market, and less an allowance for profit to the elevator operator for handling the grain. Thus, if the market price on the Gulf on a particular day was $3.95 per bushel, and the freight rate to get it there was 75 cents per bushel, and the elevator operator needs 15 cents per bushel to cover expenses and make a reasonable profit on handling the grain, he would offer producers a track price at his location of $3 per bushel. To a large extent, freight was a neutral factor in the marketing decision, although there were some differences due to location and carloading capability. The difference created by location simply reflected the fact that some locations were further from the Gulf than others and therefore paid a proportionally higher freight rate. This difference didn't effect competitiveness because of the concurrent cost producers would have to haul by truck to a closer market. Additionally, the differences created by efficiency of operation or carloading capabilities were determined by each elevator owner. If you wanted the better rate, you simply invested in your physical plant to make it more efficient to obtain the benefit of any freight differential available.

The Staggers Rail Act of 1980 authorized railroads and shippers to enter into contracts to set freight rates. In January 1983, the Union Pacific Railroad entered into a contract with the new type of elevator facility in Colby, Kans. While I do not know what this contract rate is, I firmly believe that it has operated to unfairly discriminate against the elevator facilities that I manage, and others like mine. My opinion is based upon the facts that the contracts rate is secret; that multiple car rates previously available to other shippers, which are also based upon efficiencies of operation, are no longer available to our facility, and the rate differenctial granted by the contract is so great, that it cannot be justified on the basis of efficiencies of operation or volume.

First, prior to Staggers, all freight rates were public knowledge and took the form of published tariffs. Under those tariffs, the freight difference between a move to the Gulf on the Union Pacific from Monument, Kans. and Colby Kans., was approximately 0.5 cent to 1 cent per bushel. My freight rate at Monument was about 1 cent higher to reflect the fact that I was 22 miles further out on the Union Pacific from the Gulf.

Also, multiple car and volume based freight rates were part of the published tariff system prior to Staggers. The Union Pacific had published freight rates based upon single car and multiple car moves. The rates for multiple car moves were lower. This policy encouraged shippers to upgrade their facilities to realize a freight savings. Based upon the existence of these multiple car rates, we invested $75,000 in our facility at Monument to get a 25-car loading capability. Under the published tariffs in effect at that time, we were able to save about 10 cents per bushel on our rates to the Gulf based on a 25-car move. We were willing to make this type of an investment because it made us more competitive. The decision was ours—no one elses.

I can't tell you what freight rate the Union Pacific has given to the new Colby facility by contract. Because of the substantial difference in paying price that the Colby facility is able to offer, compared to my paying prices, I suspect that the rate is about 20 cents per bushel, or 33 cents per hundredweight less than what is available to other shippers in the area. Let me give you an example of what differences there are in paying prices.

The Colby facility was completed in November 1982, and started business in January of 1983. On January 4 and 5, what I think were the first 2 days of operation, it opened with a paying price 14 cents per bushel greater than I was able to offer. By February 1983, the difference had increased to 17 cents. To get within 15 to 17 cents of their paying price, I had already cut my margin on grain by over 50 percent.

I submit that this difference is not justifiable by reason of location or any particular cost savings due to efficiency of operation or volume.

Let me give you some comparative figures on the freight rates that are included in the Union Pacific's published tariffs as a point of reference for you. The present UP tariff publishes freight rates available at Monument and Colby, Kans., based on 5-, 25-, and 50-car rates. Even though I told you our facility at Monument has a 25-car loading capability, the Union Pacific does not make that rate available to us because we are not a terminal location. The best rate I can get is a 5-car direct shipment to the Gulf. The 25-car rate is not available to me. However, assuming that these rates were available, the following chart shows what they are:

POINT OF ORIGIN FREIGHT RATE COMPARISON

[Hundredweight/bushels]

Location	5-car rate	25-car rate	50-car rate
Monument	$1.43/85.8	$1.27/76.2	$1.22/73.2
Colby	1.42/85.2	1.26/75.6	1.21/72.6
Difference (cents)	.01/0.6	.01/0.6	.01/0.6

This chart demonstrates that the freight differential between the points of origin, Monument and Colby, are a consistent 1 cent per hundredweight or 6 cents per bushel., irrespective of the rate that is being compared. This difference simply reflects the fact that the haul from Monument to a Gulf destination is 22 miles further from Monument. This freight difference is justifiable and no one is complaining about it. This difference is not a factor in the paying price difference that exists between my facility and the one at Colby.

As I stated previously, multiple car rates were in effect prior to Staggers and reflect savings that can be obtained by efficiency of operation or volume. Even though I can't get a 25-car rate to the Gulf, that tariff reflects the amount of savings that would be available in such a move. The following chart compares the freight savings that are available in the current 5-, 25-, and 50-car rates:

Multiple car freight rate comparison

[Hundredweight/bushels]

No. of cars	*Rate*
A. 5 versus 25:	
5	$1.43/85.8
25	1.27/76.2
Difference (cents)	.16/9.6
B. 25 versus 50:	
25	1.27/76.2
50	1.22/73.2
Difference (cents)	.05/3
C. 50 versus 75:	
50	1.22/73.2
75	1.19/71.7
Difference (cents)	.03/105

This chart demonstrates that efficiencies of operation based upon higher multiple carloadings are rewarded with lower rates. Again, there is the same consistency of cost savings between the Monument and Colby locations. The 25-car rate is 16 cent per hundred weight, or 9.6 cent per bushel less than the published 5-car rate. Predictably, the 50-car rate is less than the 25-car rate; but it represents only about one-half of the difference that exists between the 25-car rate and the 5-car rate. The 50-car rate is 5 cent per hundred weight or 3 cent per bushel less than the 25 car published tariff. While the Union Pacific does not and has not had a published 75 car rate, if the trend shown by comparing the 5-, 25-, and 50-car rates would be extended to a 75-car rate, that rate would be about 2.5 cent per hundred weight or 1.5 cent per bushel less than the 50-car rate.

For purposes of argument, let us assume that I am right about what the Union Pacific 75-car rate would be, and that it is 70.7 cent per bushel, the 71.7 cent per bushel as shown on the chart, less 1-cent distance differential at Colby. Since my facility has a 25-car loading capability, I should be entitled to the rate that is justified by my efficiency of operation, which under the published tariff is 76.2 cent per bushel for a 25-car loading capability. If this were true, the facility at Colby would be getting a total of 5.5 cent per bushel break on the freight rate: 1 cent per bushel difference because it is 22 miles closer; and 4.5 per bushel because of the efficiency involved. I submit to you that if the difference in rates available to my facility and the one at Colby were 5.5 cent per bushel, the gross disparity in paying price would not be present. My conclusion is that the contract rate in effect is not based nor justifiable on the basis of efficiencies of operation.

Since Staggers, as interpreted by the Interstate Commerce Commission, authorizes contract rates to be kept secret, I am left in a position of playing blindmans bluff to compete against this rate. How much do I cut my margin; how long can I incur a loss to try to remain competitive.

I can't effectively challenge the contract rate before the Interstate Commerce Commission. The Commission, through its regulations, has determined that everything about the contract should be kept secret except the name of the carrier, the commodity involved and the length of the haul. How can you challenge such a rate if you don't know what it is. Futhermore, while the Staggers act provided contract rates to be effective on 30 days notice, to permit shippers to object, the ICC has now permitted these rates to become effective on one days notice. I think this simply reflects the Commission's determination that no one challenge the rates because they don't know what they are or who they involve, so why even provide for a time period to file objections.

Additionally, I have been advised by ICC counsel that unless I can show that the Union Pacific has market dominance over my facilities, the ICC won't even hear a challenge to the reasonableness of the rate. The fact that UP is the only railroad serving me, I am told, does not satisfy the test of market dominance. Therefore, its unlikely that I could get before the Commission to challenge the reasonableness of whatever differential exists between my rate and the rate at Colby.

Secondly, I have been told that I would probably have the burden of proof to show that the contract rate is unreasonable. There are a series of formulas that determine who has the burden of proof and I understand that in almost any circumstance imaginable, the shipper will always bear the burden of proving rate unreasonableness.

Under the circumstances, I don't know what I can do. We have made a $75,000 investment to get a 25-car loading capability; but currently that rate is not available to me. The facility that I manage is not being rewarded for the level of efficiency that it has been obtained; but there is little doubt that the Colby facility is. I submit that the existence of the contract rate provision in Staggers encourages this kind of situation.

Under the circumstances, I certainly can't justify any additional capital improvements in my facility to make it more efficient, when I cannot realize the benefit of the level of efficiency that I have presently obtained. Even if we could afford to file a complaint with the Interstate Commerce Commission, given the Commission's bias for "total deregulation", I've been told by counsel that we don't have the proverbial "prayer's chance in hell" of success. I had the counsel for the Kansas Grain and Feed Dealers Association contact the Railroad Contract Rate Advisory Service of the Interstate Commerce Commission for me to see what I could do about my situation. I have been informed that the Director of that service at the Interstate Commerce Commission told our counsel that there was nothing that could be done, but that we might try calling the Transportation Section Chief of the Antitrust Division of the Department of Justice because it didn't sound like this type of situation should be permitted.

About a month ago, I read an article in the Farm Bureau news about this new facility in Colby. The manager of it said that they did have bargain rail rates and that they expected to pull wheat, milo and corn from southwestern Nebraska, eastern Colorado, and southwestern Kansas. The article also reported that the facility had to move about 40 unit trains a year, which is a volume of approximately 10 million bushels of grain.

With this kind of annual volume requirement, it is apparent that this facility, with its contract rate, will have an impact that will be felt for many miles around. I feel it very strongly just 22 miles away. In all of 1981, total wheat production in Thomas and the four surrounding counties, Rawlins, Sheridan, Sherman, and Logan, was only 13,452,300 bushels. If a facility like the one at Colby has a freight rate that can control a 10 million bushel annual volume, every country elevator in that five county area can simply fold up its tent and go home.

I have no quarrel with a difference in freight rate that can be justified by some cost savings that is achieved by efficiencies of operation. What I am against is a freight differential that is secret; that is not justified on the basis of direct cost savings obtained by efficiency of operation; and that is employed to "buy" rail traffic and promote unfair competition. On the facts of my example, if the Union Pacific would simply publish a 75-car rate, that facility in Colby could have that rate; and I could have my 25-car rate. If the differential between a 25-car and 75-car rate was greater than in the example I've given in this statement, then I would have a decision to make: either make an additional investment to get the freight rate; or learn to live with the differential. Right now, I don't know what the differential is, I can only guess. We have made improvements in our facility to get efficiency of operation, but we can't get a rate that recognizes efficiency we have.

Since I am at wits end about what to do to remain competitive, or to challenge the situation, I am glad I have had the opportunity to testify here today so that I can ask you, "What can we do?"

Senator **Kassebaum**. Thank you very much, Mr. Runnalls. Mr. Henrickson.

Mr. **Henrickson**. Thank you, Senator Kassebaum. My name is Toliff Henrickson. I am 68 years old and for the last 42 years have been managing and building a country elevator business in Logan. The pictures I present will show our facility in 1945 as compared to the facility in the spring of 1982.

My business has the storage capacity of approximately 792,000 bushels, store and merchandise grain; sell feed, liquid feed, seed, fertilizer, salt, chemicals, and general merchandise. I mix and blend feed, clean and treat seed, and blend and apply fertilizer and chemicals. My business is located on the Missouri Pacific Railroad, which is now merged with the Union Pacific. I am a captive shipper to that railroad because I have no shipping alternative other than truck, which I have never considered to be an alternative to rail transportation because it is costly and inefficient.

My business is a family business just like the family farm. I worked at it for 42 years and suspect that I have made an investment of more than $1 million in the business. All three of my sons and my daughter are stockholders of the business, and my youngest son is actively involved in management of it.

I am testifying here today because I have what I consider to be a well-founded fear that contract rate provisions of the Staggers Rail Act of 1980 is an economic death sentence for my business. I say this for the following reasons: My facility, like any country elevator, must have the ability to store and merchandise grain to remain a viable business concern. I cannot depend on the fertilizer, feed, and general merchandising operations to sustain the business. I must be competitive in storing and merchandising grain. Since Staggers, I think I have lost that ability to compete.

In the last 2 years especially, I have seen my trade territory shrink noticeably, as you will notice on the chart. In 1981 I could be competitive 18, 20 miles to the south, 6 miles to the north, 9 miles to the west, and about 5 miles to the east. Now I am only competitive 9 to 10 miles south, not at all to the north, about the same east and west. While I was in competition with other country elevators in 1981, I am now having to compete with three terminal elevators that apparently have extremely advantageous contract rates. Grain is being trucked out of my trade area to a terminal facility at Colby on the Union Pacific some 80 miles to the west, to a terminal facility on the Burlington-Northern, that is, Superior, Nebr., some 110 miles to the east or northeast, and to a terminal facility at Salina, Kans., served by several railroads some 150 miles to the east and southeast.

The increase in the use of trucks has been precipitated and promoted by the existence of the contracts at the terminal facilities that I just mentioned. Prior to the implementation of these contract rates, grain was not moving by truck, it moved by rail. In 1980 I shipped only five trucks from my elevator. In 1981, before these contracts were in existence, my facility handled 334,870 bushels; and by the way, it was that lesser amount because of a tremendous freeze we had in the wheat area. Every last bushel, 100 percent of this grain, is moved by rail. However, since these facilities with their contract rates have been in existence, my rail shipments have decreased such that in 1982, 79 percent of my grain moved by rail, the balance of 21 percent moved by truck. It took 107 trucks to move this grain. So far in 1983, 48 percent of the total outbound shipments was by truck, 52 percent by rail. Consider also that it took 230 trucks to move that 218,500 bushels of grain comprising 48 percent of the total outbound, and only 71 railcars to move the 52 percent. In all of 1980 and 1981, I only used five trucks, but in the first half of 1983 I have already used 230 trucks. These truck movements were generally to the east terminal facilities, which were able to offer the best possible price, even for me, due to what must be substantially lower rail transportation costs at these terminals.

Today I am handling much less grain, stated as a percentage, of what is being produced in my area because of the existence of these contracts. In 1980 I handled approximately 18 percent of the grain produced in Phillips County, and I might state that we worked in three area counties surrounding us. However, in 1983 my percentage handled decreased from 18 to about 9 percent, cut in half since Staggers was enacted. This grain is being diverted to terminal facilities because of the tremendous advantage given to such facilities by the railroad in such contracts.

I sometimes question whether Missouri Pacific, which is now being merged with Union Pacific, has any real interest in generating traffic from my station. We are supposed to get triweekly service, which in our area of the country means get served once a week and try again the rest of the week. We have complained about our service to the ICC with little results. In April 1983, we ordered 125 hopper cars for harvest. In July 1983, during harvest, we got 23 cars.

Since the Union Pacific Railroad and Missouri-Pacific Railroad are now one and the same railroad and since I believe the good percentage of grain I normally handle is being diverted to Colby, which is on the Union Pacific, I doubt that there is any real incentive for the Missouri-Pacific to provide me with service. To the railroad the objective is to get the grain. I think they could care less whether they get it from me at Logan or from the terminal at Colby, so long as they originate the grain shipment. In fact, I suspect they would rather the grain originate at Colby, that they would not have to give me cars or switch the traffic I have. Also, since I am a branch line, I wonder if the line might be considering abandonment if I am not able to use it.

There may be some who would suggest that my type of facility, the country elevator, is a relic of the past and has no place in the grain handling and market system of today. My answer is that we have historically shown that our type of facility is the most efficient and best overall method to service the producer, not only by supplying grain storage and merchandising services, but also the other services that I have talked about. If I am to be effectively cut out of the grain handling and gathering market, if the country elevator is to be bypassed by direct farm to terminal movements, I think someone should answer these questions: Who is going to provide grain storage for our producers? Who is going to issue warehouse receipts for them? Who is going to provide permanent records on each individual farm? Who is going to provide all the services that a country elevator does for his community? Who is going to provide a competitive market? Another point I intended to bring out, who is going to provide the scales to weigh the farmers' cattle, hay bales and everything else the farmers want weighed at the country elevators?

In short, if the transportation policy that Staggers has fostered leads to the demise of the country elevator, who is going to provide those services that I have talked about here today as efficiently as country elevators have been providing them to producers? I can guarantee you that the export houses and terminal facilities that get the economic advantage in these contracts will not perform them. They do not now and they do not care to. They simply want the competitive advantage to lock in the cash grain market.

In conclusion, the Staggers Rail Act of 1980, primarily through the implementation of the contract rate provision, has unfairly discriminated against country elevators by permitting railroads to secretly grant substantial freight rebates based on volume that are not justified as a direct cost savings to the rail carrier. The act simply guarantees that the shipper fortunate enough to obtain a contract will definitely get the required volume and the country elevator will be eliminated as a competitive factor. Thank you for being able to appear.

[The statement follows:]

STATEMENT OF TOLIFF R. HENRICKSON ON BEHALF OF LOGAN GRAIN CO., INC., AND KANSAS GRAIN AND FEED DEALERS ASSOCIATION

Senator Kassebaum and members of the committee, my name is Toliff R. Henrickson. I am 68 years old and for the last 42 years have been managing and building a country elevator business, Logan Grain Co., Inc., in Logan, Phillips County, Kans. My business has a storage capacity of about 792,000 bushels of grain and I consider it full service, because I handle, store and merchandise grain, sell feed, liquid feed, seed, liquid fertilizer, salt, chemicals, and general merchandise. I mix and blend feed, clean and treat seed, and blend fertilizer. My business is located on the Missouri-Pacific Railroad which has now merged with the Union Pacific. I am a "captive" shipper to that railroad because I have no shipping alternative other than truck, which I've never considered to be an alternative to rail transportation because it is costly and inefficient.

My business is a family business, just like a family farm. I have worked at it for 42 years and suspect that I have made an investment of more than $1 million in the business. All three of my sons and my daughter are stockholders of the business and my youngest son is actively involved in management of it.

I am testifying here today because I have, what I consider to be a well founded fear, that the contract rate provision of the Staggers Rail Act of 1980 is an economic death sentence for my business. I say this for the following reasons.

My facility, like any country elevator, must have the ability to store and merchandise grain to remain a viable business concern. I cannot depend on the fertilizer, feed and general merchandising operations to sustain the business. I must be competitive in storing and merchandising grain. Since Staggers, I think I've lost the ability to compete.

In the last two years especially, I have seen my trade territory shrink noticeably. In 1981, I could be competitive 18 to 20 miles to the south, 6 miles to the north, 9 miles west and about 5 miles east. Now, I am only competitive 9 to 10 miles south, not at all to the north and about the same east and west. While I was in competition with other country elevators in 1981, I am now having to compete with three terminal elevators that apparently have extremely advantageous contract rates. Grain is being trucked out of my trade area to a terminal facility at Colby on the Union Pacific, some 80 miles to the west; to a terminal facility on the Burlington Northern at Superior, Nebr., some 110 miles to the east northeast; and to a terminal facility at Salina, Kans., served by several railroads some 150 miles to the east southeast.

The increase in the use of trucks has been precipitated and promoted by the existence of the contracts at the terminal facilities that I just mentioned. Prior to the implementation of these contract rates, grain wasn't moving by truck; it moved by rail. In 1980, I shipped only five trucks from my elevator. In 1981, before these contracts were in existence, my facility handled 334,870 bushels of wheat; every last bushel, 100 percent of this grain, moved by rail.

However, since these facilities, with their contract rates, have been in existence, my rail shipments have decreased such that in 1982, 79 percent of my grain moved by rail; and the balance 21 percent moved by truck. It took 107 trucks to move this grain. So far in 1983, 48 percent of my total out-bound shipments have been by truck; 52 percent has been by rail. Consider also that it took 230 trucks to move that 218,500 bushels of grain comprising 48 percent of the total out-bound; and only 71 rail cars to move the 52 percent. In all of 1980 and 1981, I only used 5 trucks; but in the first half of 1983, I've already used 230. These truck movements were generally to these terminal facilities, which were able to offer the best possible price even for me, due to what must be substantially lower rail transportation costs.

Today, I am handling much less grain, stated as a percentage, out of what is being produced in my area, because of the existence of these contracts. In 1980, I handled approximately 18 percent of the grain that was produced in Phillips County, Kans. However, by 1983, my percentage handled had decreased to about 9 percent cut in half since Staggers was enacted. This grain is being diverted to terminal facilities because of the tremendous advantage given to such facilities by the railroads in such contracts.

I sometimes question whether the Missouri-Pacific, which has now been merged with the Union Pacific, has any real interest in generating traffic from my station. We are supposed to get triweekly service, which in our area of the country means get served once a week and try again the rest of the week. We have complained about our service to the ICC with no results. In April 1983, we ordered 125 cars for harvest. In July 1983, during harvest, we got only 23 cars.

Since the UP and the MOP are now one in the same railroad, and since I believe the good percentage of grain I normally handled is being diverted to Colby, which is on the UP, I doubt that there is any real incentive for the MOP to provide me with service. To the railroad, the objective is to get the grain. I think they could care less whether they get it from me at Logan or the terminal at Colby, so long as they originate the grain shipment. In fact, I suspect that they would rather the grain originate in Colby, that way they wouldn't have to give me cars or switch the traffic I have.

There may be some who would suggest that my type of facility, the country elevator, is a relic of the past and has no place in the grain handling and marketing system of today. My answer is that we have historically shown that our type of facility is the most efficient and best overall method to service the producer; not only by supplying grain storage and merchandising services; but also the other services that I have talked about.

If I am to be effectively cut out of the grain handling and gathering market, if the country elevator is to be bypassed by direct farm to terminal movements, I think someone should answer these questions:

1. Who is going to provide grain storage services for producers? Of the storage available in Kansas 70 percent is commercial storage, the bulk of which is in country facilities like mine. You can't have a storage business without being able to market the grain in store. If we go out of business what are the alternatives? The terminals with these advantageous contract rates are primarily "through put" ele-

vators. They deal in the cash grain market and many won't even accept grain for storage.

2. Who is going to issue warehouse receipts for farmers? Many of my producers have grain in storage under government loan or farmer-owned reserve programs. Where is that grain going to be stored and who will issue warehouse receipts for it? Is Congress, by enacting such a transportation policy as I have described here today, telling producers they are duty bound to invest in their own on-farm storage and in their own transportation equipment to direct market grain and totally by-pass country elevators?

3. Who is going to dry grain that has too much moisture to be handled?

4. Who is going to sell and custom apply fertilizer?

5. Who is going to sell, and manufacture, mix and blend feeds?

6. Who is going to provide the scales to weigh cattle, hay bales and everything else that farmers want weighed at the country elevator?

In short, if the transportation policy that Staggers has fostered leads to the demise of country elevators, who is going to provide those services that I have talked about here today as efficiently as country elevators have been providing them to producers? I can guarantee you that the export houses and terminal facilities that get the economic advantage in these contract rates will not perform them. They don't now; and they don't care too. They simply want the competitive advantage to lock in the cash grain market.

In conclusion, the Staggers Rail Act of 1980, primarily through the implementation of the contract rate provision, has unfairly discriminated against country elevators by permitting railroads to secretly grant substantial freight rebates based on volume that are not justified as a direct cost savings to the rail carrier. The act simply guarantees that the shipper fortunate enough to obtain the contract will definitely get the required volume and that the country elevator will be eliminated as a competitive factor.

Senator KASSEBAUM. Thank you, Mr. Henrickson. I would just like to say that Mr. Taylor has to leave to catch a plane and cannot stay any longer. Mrs. Rosenak and Miss Gibbons will be staying and have extensive knowledge in rail deregulation and can answer any of the questions. I would just like to say thank you again, I very much appreciate your being with us.

Mr. TAYLOR. I am just delighted to have been here, Senator. This is one Commissioner on the ICC who is very glad he got out of the office and came out here and heard some things that are going on where it is going on. So I appreciate the opportunity; it has been very, very helpful to me. Jan Rosenak will stay, as will Gail Gibbons, and I am sure they will make adequate notes for me of everything that transpires. Also, they'd be glad to stay after the hearing has concluded and perhaps informally discuss any questions or problems or other information that you would like to impart. Again, many, many thanks to all of you for putting up with all of us. We appreciate being here. My thanks to you, Senator. I really enjoyed it.

Senator KASSEBAUM. We are to you, Mr. Morford, I believe.

Mr. MORFORD. Senator Kassebaum, my name is Duane Morford. I have been involved in agribusiness for 15 years, the last 7 of which I have spent as general manager of Lorraine Grain, Fuel, and Stock Co. at Lorraine, Kans. I am also a member of the Kansas Grain and Feed Dealers Association Transportation Committee. The Lorraine Grain, Fuel and Stock Co. at Lorraine is a Kansas cooperative association which now has approximately 650 members. The association was formed in 1904 and for the past 78 years has served the farmer members in our community. We also have a 200,000 bushel grain and storage facility in Geneseo, which is located in Rice County. The Lorraine facility is served both by the Santa Fe and the Burlington Northern Railroad and is located at the head of the Galatia branch of the Santa Fe. The Geneseo facility is located on the main line of the Missouri Pacific.

We run a full service country elevator operation and handle grain, feed, liquid feed, seed, petroleum products, bulk and liquid fertilizer, anhydrous ammonia, salt, chemicals, and general merchandise. But the bread and butter of our operation is the grain handling and storage business. I think without this capability, there would be no way we could remain in business.

I want to testify about two aspects of the Staggers Rail Act of 1980: First, the relative ease of which a railroad can abandon an agricultural branch line, even though a line may be profitable and abandonment is not in the public interest; the second, the abuse of the seasonal demand rates by the railroads and inequities created thereby.

First, I would like to talk about abandonment of branch lines since the enactment of the Staggers Act. I understand that the Interstate Commerce Commission has only recently denied its first abandonment application petition in the nearly 2 years that have passed since the Staggers Act. With this one exception, the Commission has rubberstamped every application for abandonment, even if the line is profitable and even if the abandonment is not in the public interest.

Presently the Burlington Northern, which operates the line serving my facility at Lorraine, has listed our line which runs from Buhler to Ellsworth for abandonment. Burlington Northern marketing representatives have told me that it has been listed as category 1, which I understand means that the line could be abandoned within the next year. An abandonment by the Burlington Northern would also cut off the Lorraine to Galatia branch line of the Santa Fe, because the Santa Fe Railroad uses the Burlington Northern line from Lyons to Lorraine in order to make connection with their traffic and everything that goes out from Lorraine out to Galatia. If abandonment is permitted and if the Santa Fe does not buy the access line, then all of the shippers located on the branch line will be deprived of rail freight service as well as the shippers on the Burlington Northern line.

There are eight agricultural shippers located on this branch line. I am speaking now just about the Santa Fe line. There are also, I believe, four or five shippers on that Burlington Northern line. The facilities on the Santa Fe branch line have a combined storage capacity of almost 4 million bushels of grain per year—excuse me, they have a combined storge capacity of 4 million bushels. Their facilities all together represent an original investment of approximately $5.3 million and a replacement value of around $8 million. Historically, the elevators located on this line ship 3.6 million bushels of grain annually. That represents 1,090 carloads. All of this grain can move and should move by rail. However, whether it does or not depends on whether the railroad wants the traffic. We are concerned that the railroads are using contract rates to draw grain into terminal facilities and then use the concurrent drop in carloadings out on the branch lines to justify abandonment of their common carrier obligation to those branch lines.

I would give you an example. My facility at Lorraine, we usually handle and move around 800,000 bushels of grain per year. Almost all of the grain has historically moved by rail. However, since the implementation of the contract rates at various centers around my facility, a greater amount of this grain is moving by truck to these markets because of the great competitive advantage enjoyed by those terminals. Additionally, this last harvest, I was forced to move approximately 150,000 bushels by truck simply because I could not get rail cars, and this was just during the 9 days that harvest lasted this year. The railroad therefore lost 45 carloads it normally would have received, and I was forced to ship 150 truckloads of grain. I lost on the move. It cost my co-op 8 to 9 cents per bushel more to ship by truck, depending on what rate we were able to negotiate with the trucker, which is an additional $12,000 to $13,500 in transportation costs that would otherwise be profit to our cooperative and then subsequently to the producer. I suspect that the railroad would use these decreasing carloads to help justify an abandonment later on.

In addition to not getting the cars that I have ordered, the railroad can allow service to deteriorate or to become noncompetitive in order to lose business and thereby justify an abandonment. In 1981, from Lorraine, I shipped 133 cars on the Burlington Northern and only 52 by Santa Fe. In 1982, the Burlington Northern let its published tariffs become noncompetitive. They were 9 cents per bushel higher than Santa Fe rates. Also, the Burlington Northern restricted rates on hopper cars to two-thirds capacity because they chose not to repair a bridge at Medora, Kans. This affected the Burlington Northern shipments but not the Santa Fe because it was not on the part of the line that the Santa Fe uses. As a result, in 1982, I only shipped 28 cars on the Burlington Northern and 119 on the Santa Fe. Again, I suspect the Burlington Northern can now use its decreasing cars to justify the proposed abandonment.

Speaking for myself and other shippers on the branch line, we do not want to see the line abandoned. We feel it not only would be detrimental to us but also to our producers. If we have to go 100 percent to truck traffic, it will be from 9 to 15 cents more per bushel transportation costs, and that cost will definitely have to be passed on to the producer, some of which will be able to go maybe to another country elevator that is on a rail line, but there will be some that will be far enough away that the distance and the time involved during the middle of harvest will prevent them from going and they will possibly still have to do business with our elevator even though they might have to take 15 cents less per bushel for their grain.

We think that the current transportation policy dooms our line for abandonment for the following reasons: The existence of contract rates at elevator facilities on nearby lines draws grain from our normal trade area and leads to a decrease in carloadings, which can be used by our carrier to justify abandonment. We are facing much stronger competition from facilities in Hays, Russell, and Salina. People on our branch lines suspect that we are being forced to compete with advantageous contract rates that have been given to these facilities. But as other testimony to you has indicated, the existence of these contracts and the rates provided for in them are secret so we really do not know how low they really are.

Since the ICC has only rejected one abandonment petition in almost 2 years, we have no reason to suspect that there is any real chance of fighting the planned abandonment of our line. We though we could show that we were a profitable line because we always used the railroad. However, we have been informed by ICC counsel that line abandonment has been permitted by the ICC where the abandoning carrier was receiving profit from the branch line abandoned.

Rail service and condition of rail facilities are being permitted to deteriorate substantially. When I order 11 cars and only get 4 to move grain and I have to move the balance by truck, I find myself in a catch-22 situation. I must move the grain, but by moving it by truck, my carloadings for the railroad go down. My carloadings go down, I give the railroad the opportunity to justify abandonment because the rail traffic is not there anymore. I suspect that contract rates even have a lot to do with the lack of service as car commitments are probably being made to terminal facilities service by contracts to the detriment and damage of country elevators.

The second impact that Staggers has had on my cooperative facilities and others like mine has been the inequities created by rate changes which are usually implemented immediately preceding or following peak or demand-sensitive movements. And just to put that a little more in perspective, what actually happens, we will have a higher freight rate at the time when we really need to move the grain and then lower at other times, and then we find that the rate that we are charged depends on how high that rate was. The rate in effect the date of shipment or the rate in effect the date of sale is the rate we are charged depending on which one is higher. Just let me give you an example, if we can run down through an example, and hope to try to explain that.

Say a producer-member of my cooperative desired to participate in the Government loan program and he had brought wheat to me, we would have shipped his wheat to a terminal facility in Wichita for transit storage based on gulf movement. The published tariff on the date of the shipment was 81 cents a bushel. Transit is allowed under the tariff and the terminal facility issued the warehouse receipt. When the grain was finally sold, the gulf rate had decreased to 54½ cents a bushel; however, the carrier did not pass on the benefit of the decreased freight rate. Settlement in this situation was based upon the published rate in effect on the date of shipment and not the actual transportation rate in effect on the date of sale. The difference is 26½ cents per bushel. That difference comes out of my cooperative's pocket.

Since we are operating on a profit margin of approximately 15 cents per bushel, you can readily see on this sale, we not only failed to make money, we lost a substantial amount, 11½ cents per bushel, for handling the grain.

We have two choices in this case, either absorb this amount or pass it on to the producer, who would receive 26½ cents per bushel less for his grain simply because he chose to participate in the Government loan program. I do not think that this result was intended by rail deregulation. Even though the banking industry has been deregulated to some extent recently, bankers are not permitted to make variable rate promissory notes that only go up to reflect increases in interest but never go down to reflect decreases. And this is what is happening to us on our rail rates.

However, under the Staggers Act, rail carriers are permitted to establish this one-way policy, I assume so that they can produce additional revenues. To this extent, producers and shippers get no advantage of decreased rail rates.

In conclusion, I have the genuine fear that under Staggers, especially as interpreted by the present ICC, any rail carrier will be permitted to abandon any line of railroad that it desires, even if that line of railroad is producing adequate revenues under current Commission regulations. Even if the profitability of the line is at issue in an abandonment hearing, there are many things that the railroad can do to insure that a line it wants to abandon is not producing revenue. The railroad can implement de facto abandonment by one of several means. While I am sure there are other factors, I have testified here today about how contract rates on nearby lines of the same or competing railroads can take grain away from the origins on the branch line, which reduce carloadings on these lines. Additionally, by giving poor service and not providing cars ordered, a railroad can create a set of facts that make abandonment a self-fulfilling prophecy, and there is nothing the shipper can do about it.

We urge you to make this the first of several additional oversight hearings on Staggers. The Kansas Grain and Feed Dealers Association is working with 13 other State grain and feed dealers associations and with the national grain and feed dealers association to propose legislative solutions to the problem we have identified. We hope that this is the start of a continuing dialog. I thank you.

[The statement follows:]

STATEMENT OF DUANE MORFORD ON BEHALF OF LORRAINE GRAIN, FUEL & STOCK CO., A COOPERATIVE ASSOCIATION, AND KANSAS GRAIN AND FEED DEALERS ASSOCIATION

Senator Kassebaum and members of the committee: My name is Duane Morford. I am 38 years old and have been involved in agri-business for 15 years, the last 7 of which have been spent as the General Manager of Lorraine Grain, Fuel & Stock Co., a Kansas cooperative association of approximately 650 members. My cooperative members own two facilities: a 660,000 bushel elevator at Lorraine, in Ellsworth County, Kans.; and a 200,000 bushel facility at Geneseo, located in Rice County, Kans. The Lorraine facility is served by both the Santa Fe and the Burlington Northern, and is located at the head of the Galatia branch line of the Santa Fe. The Geneseo facility is located on the main line of the Missouri-Pacific Railroad.

We run a full service country elevator operation. We handle grain, feed, liquid feed, seed, petroleum products, bulk-liquid fertilizer, anhydrous ammonia, salt, chemical, and general merchandise. The bread and butter of our operation is a grain handling and storage business. Without this capability, I do not think we could remain in business.

I want to testify about two aspects of the Staggers Rail Act of 1980: first, the relative ease with which a railroad can abandon an agricultural branch line even though the line may be profitable and abandonment is not in the public interest; and second, the abuse of seasonal demand rates by railroads and the inequities created thereby.

First, I would like to talk about abandonment of branch lines since the enactment of the Staggers Rail Act of 1980. I understand that the Interstate Commerce Commission has only recently denied its first abandonment application petition the nearly two years that have passed since the prior Staggers Act oversight hearings held by this subcommittee November 10, 1981. With this one exception, the Commission has "rubber stamped" every application for abandonment, even if the line is profitable, and even if abandonment is not in the public interest.

Presently, the Burlington Northern, which operates the line serving my facility at Lorraine, has listed our line (from Buhler, Kans., north to Ellsworth, Kans.) for abandonment. I have been told by BN marketing representatives that the listing is a "Category 1" abandonment, which apparently means that the line can be abandoned within the next year. An abandonment by BN would also cut off the Lorraine to Galatia branch line of the Santa Fe Railroad. Currently, the Santa Fe is operating over the BN line from Lyons north to Lorraine to serve the facilities located on the branch line. If abandonment is permitted, and the Santa Fe does not buy the access line, all of the shippers located on the branch line will be deprived of rail freight service and will face severe competitive disadvantages.

There are eight agricultural shippers located on this branch line, including my facility at Lorraine. Other facilities on the line, from east to west, are: Hollyrood, Farham, Hitschmann, Beaver, Susank, Stickney and Galatia. These facilities have a combined storage capacity of almost 4 million bushels of grain, and their facilities in the aggregate represent an original investment of approximately $5.3 million, which have a replacement value of about $8 million. Historically, the elevators located on this line ship 3.6 million bushels of grain annually, which represents 1,090 carloads. All of this grain can move and should move by rail. However, whether it does or not depends on whether the railroad wants the tariffic. We are concerned that railroads are using contract rates to draw grain into terminal facilities and use concurrent drop in carloadings out on branch lines to justify abandonment of their common carrier obligation to those branch lines.

Let me give you an example:

My facility at Lorraine will usually handle and move about 800,000 bushels of grain per year. Almost all of the grain has historically moved by rail. However, since the implementation of contract rates at various centers around my facility, a greater amount of this grain is moving by truck to these markets because of the great competitive advantage enjoyed by these terminals. Additionally, this last harvest, I was forced to move approximately 150,000 bushels by truck simply because I could not get rail cars. The railroad lost 45 carloads that it normally would have received, and I was forced to ship the grain by truck—all 150 of them. I lost on the move as well. It cost my coop 8 cents a bushel more to ship by truck, an additional $12,000.00 in transportation cost, that would otherwise be profit to the cooperative and to the producer. I suspect that the railroad will use this decrease in carloads to help justify an abandonment later on.

In addition to not getting cars that I've ordered, the railroad can allow service to deteriorate or to become noncompetitive, in order to lose business, and thereby justify a later abandonment. Consider the following. In 1981, from Lorraine, I shipped 133 cars on the BN, and only 52 on the Santa Fe. In 1982, the BN let its published tariffs become non-competitive. They were 9 cents per bushel higher than Santa Fe rates. Also, BN restricted weight on hopper cars to two-thirds capacity, because they chose not to repair a bridge at Medora, Kansas. As a result, in 1982, I only shipped 28 cars on the BN; 119 were loaded out on the Santa Fe. Again, I suspect the BN can now use this decrease in cars to justify the proposed abandonment.

Speaking for myself and the other shippers on the branch line, we do not want to see the line abandoned. We think, however, that the current transportation policy dooms our line for abandonment for the following reasons:

The existence of contract rates at elevator facilities on nearby lines draw grain from our normal trade area and leads to a decrease in carloadings, which could be used by our carrier to justify abandonment. We are facing much stronger competition from facilities in Hays, Russell, and Salina. People on our branch line suspect that we are being forced to compete with advantageous contract rates that have been given to these facilities. But, as other testimony to you has indicated, the existence of these contracts, and the rates provided for in them are secret so we really don't know how low they really are.

Since the ICC has only rejected one abandonment petition in almost 2 years, there is no reason to suspect we have any real chance of fighting the planned abandonment of our line. We though we could show that we were a profitable line because we've always used the railroad. However, we have been informed by ICC counsel that line abandonment has been permitted by the ICC where the abandoning carrier was receiving profit from the branch line abandoned.

Rail service and the condition of rail facilities are being permitted to deteriorate substantially. When I order 11 cars and only get four to move grain, and I have to move the balance by truck, I am in a catch-22 situation. I must move the grain, but by moving it by truck, my carloadings for the railroad go down. When my carloadings go down I give the railroad the opportunity to justify abandonment because the rail traffic isn't there any more. I suspect that contract rates even have a lot to do with the lack of service as car commitments are probably being made to terminal facilities service by contracts to the detriment and damage of country facilities.

The second impact that Staggers has had on my cooperative's facilities and others like mine, has been the inequities created by rate changes, which are usually implemented immediately preceding or following peak or demand sensitive movements. Let me give you a concrete example of this situation.

A producer-member of my cooperative desired to participate in a government loan program. We shipped his wheat to a terminal facility in Wichita for transit storage based upon a Gulf movement. The published tariff on the date of shipment was 81 cents per bushel. Transit is allowed under the tariff and the terminal facility issued the requisite warehouse receipt.

When the grain was finally sold, the Gulf rate had decreased to 54.5 cents per bushel. However, the carrier did not pass on the benefit of the decreased freight rate. Settlement in this situation was based upon the published rate in effect on the date of sale. The difference 26.5 cents per bushel comes out of my cooperative's pocket. Since we are operating on a profit margin of approximately 15 cents per bushel, you can readily see that on this sale, we not only failed to make money, we lost a substantial amount, 11.5 cents per bushel, handling the grain.

This situation might be more palatable if we weren't operating on a one-way street. Rate policies instituted by rail carriers provide that the rate in effect on the date of shipment is used, notwithstanding a subsequent decrease in rate which becomes effective prior to date of sale and further transfer of the grain. However, in situations where the tariff in effect on the date of shipment is less than the rate in effect on the date of sale, the higher tariff on the date of sale, is used.

I don't think that this result was intended by rail deregulation. Even though the banking industry has been deregulated to some extent recently, bankers are not permitted to make variable rate promissory notes that only go up to reflect increases in interest; but never go down to reflect decreases. However, under the Staggers Act, rail carriers are permitted to establish this one-way policy, I assume so they can produce additional revenues. To this extent, producers and shippers get no advantage of decrease rail rates.

In conclusion, I have the genuine fear that under Staggers, especially as interpreted by the present Interstate Commerce Commission, any rail carrier will be permitted to abandon any line of railroad that it desires, even if that line of railroad is producing "adequate revenues" under current commission regulations. Even if the profitability of the line is at issue in an abandonment hearing, there are many things that the railroad can do to insure that a line it wants to abandon is not producing revenue. The railroad can implement "defacto" abandonment by one of several means. While I am sure there are other factors, I have testified here today about how contract rates on nearby lines of the same or competing railroad can take again grain away from origins on the branch line, which reduces carloadings on these lines. Additionally, by giving poor service and not providing cars ordered, a railroad can create a set of facts that make abandonment a self-fulfilling prophecy, and there's nothing the shipper can do about it.

We urge you to make this the first of several additional oversight hearings on Staggers. Steve Strege, the Executive Vice President of the North Dakota Grain Dealers Association is attending these hearing today. His people in North Dakota have a severe problem with branch line abandonment and contract rates. I'm sure he would like the opportunity to supplement your record with findings from the Dakota's as well. The Kansas Association is working with 13 other state grain and feed dealers associations to propose legislative solutions to the problems we've identified. We hope this is the start of a continuing dialog.

Senator KASSEBAUM. Thank you, Mr. Morford. Mr. Severe.

Mr. SEVERE. Senator Kassebaum, members of the committee, my name is John Severe, I am vice president and general manager of Western Grain, Inc. in Wichita, Kans. I am also a director and a past president of the Kansas Grain and Feed Dealers Association. Western Grain operates a terminal elevator in Wichita and several country elevators throughout the State. We are or try to be a full service operation serving the Kansas agricultural producers. Our operation must maintain the ability to handle and merchandise grain in an economic manner to be viable for our community's operation and the stockholders of the corporation.

I would like to discuss briefly two needs that I feel the Staggers Act failed to provide coverage for in the act of 1980. My first point is the need for all agriculture shippers to have the right of reciprocal switching at a reasonable cost. Current law allows reciprocal switching arrangements to be canceled arbitrarily or switching rates frequently increased to a level that would make alternate rail service unavailable. Point No. 2 is agriculture shippers need joint lines and routes between rail carriers. Currently the ICC Act permits a rail carrier to unilaterally cancel joint rates and routes. A single rail carrier may deprive shippers from markets that would otherwise be geographically accessible to him. A rail carrier with strategically placed contract rates can effect a wholesale diversion of grain from shippers and rail lines that would otherwise originate the shipment of that grain. Those are the two points.

My first example that I would submit is on reciprocal switching. Our elevator in Wichita, Kans., is located on the Burlington Northern Railroad. We are about a half a mile from the other three railroads that serve Wichita, the Santa Fe, the MOP, and the OKT. Grain moves to our elevator from various customers from all four railroads. Grain that comes in via the Santa Fe will go out via the Santa Fe, and the same is true of the MOP and the OKT and the Burlington Northern. My prepared testimony that you have that has been submitted to you shows a graph of 4 years of receipts and shipments for this terminal. But to summarize briefly, the past 4 years the average of those 4 years, 27 percent of our rail traffic came and went via the Burlington Northern, which is the line that serves our facility, 17 percent each for the OKT and the Missouri Pacific and the balance, some 40 percent, was operated in and outbound by the Santa Fe. So then 27 percent of our business handled with rail transportation was handled by the Burlington Northern and 73 percent was only handled by them as a switching service under the reciprocal agreements that they have with these other three railroads.

What this figure shows to me is that we are dependent on the Burlington Northern to switch 73 percent of the business of grain originating on other lines. Should the BN decide to increase their switching charges or cancel their switching charges, the effect that it would have on our business interests would be quite dramatic. I think our entire business would possibly be in jeopardy.

My second point, in that shippers need to have and utilize the joint rate and route to reach the best market to remain competitive in our industry and in our community, my example is based on our elevator at White City, Kans. Our elevator at White City is served only by the Cottonbelt, which is part of the Old Rock Island Railroad. This railroad does not serve the gulf export market, so must join with other railroads to reach the gulf, such as the Santa Fe at Hutchinson or Topeka, the MKT or the OKT at Kansas City or the OKT at Herrington.

While in the past we have shipped most of our grain on joint rates over the OKT at Herrington, under the Staggers Act, that rate and route can be—it has not been—canceled by either the OKT or the Cottonbelt. While cancellation of joint rates and route is a major problem, the existence of a contract at Herrington, 14 miles from our elevator at White City, is our biggest problem. We believe that a contract exists that gives our competitor 14 miles away a 10-cent-per-bushel advantage, freight advantage. That would be 15 cents a hundredweight, approximately. For some period in the spring that difference was probably double that amount. There was some rail reductions that narrowed that gap some, but we still have approximately a 10-cent-per-bushel competitive disadvantage.

Before the contract rates were in existence, we were always competitive. The slight difference, as has been testified today of a penny or two, you can handle in your own competitiveness or in narrowing margin or whatever. But this particular difference that exists up there, we believe, is not based on any size or handling efficiency. Our elevator in White City is twice the size of the elevator in Herrington. Our ability to load cars on track siding would be equal to if not as much as three times greater than that elevator in Herrington. It is our belief that that contract at Herrington exists because of a monopolistic type agreement between the elevator, being a part of a large corporation that could dictate because—maybe dictate is not a good word, but at least require a very special agreement out of that with the benefit of the other grain that goes with it on their overall contract.

I was of the opinion that deregulation was to promote competition. I believe that what we are talking about here, the reciprocal switching charge being increased or the cancellation of rates and routes or these contract rates, are in fact killing competition.

In summary, I think you and the Congress should take a hard look at the Staggers Act, which apparently you are doing a very good job of. The objectives that Congress had in mind, are they being adhered to? I do not know too much about—well, none at all about antitrust laws, but we fell it is unfair or illegal for somebody or some group to use monopolistic type powers to divide and allocate these markets that we are talking about here today.

I too want to say that we appreciate you coming out and having this hearing. I hope this is not the last. I hope we have more. I want to also add to what has already been testified to that our association will pledge its support and the cooperation of this group that they are trying to develop along with the national association to help supplement legislative ideas to help us solve these problems. Thank you very much.

[The statement follows:]

STATEMENT OF JOHN SEVERE ON BEHALF OF WESTERN GRAIN, INC. AND KANSAS GRAIN & FEED DEALERS ASSOCIATION

Senator Kassebaum and members of the committee, my name is John Severe. I live in Wichita, Kans., and am the Vice-President and General Manager of Western Grain, Inc., a Kansas corporation, which owns and operates a terminal and several country elevator facilities in Kansas. Western Grain, Inc., is totally owned and operated by Kansas investors. We have a 1,285,000 bushel terminal facility in Wichita that is located on the Burlington Northern line, but also has service available from the Santa Fe, Missouri-Pacific and Oklahoma-Kansas-Texas Railroad Companies. Our country elevator facilities include a 1,010,000 bushel storage capacity full service country elevator facility located at White City, Morris County, Kans., which is served solely by the Cottonbelt. This country elevator is a "full service" facility. We store, handle and merchandise grain, and sell feed, seed, bag-bulk-liquid fertilizer, salt and general merchandise, as well as mixing, blending and manufacturing feed.

This facility must maintain the ability to store, handle and merchandise grain to be economically viable.

I would like to discuss two needs that agricultural shippers have that I do not think are adequately provided for by the Staggers Rail Act of 1980 and the current transportation policy of this country, either as enacted or as interpreted by the Interstate Commerce Commission. Those needs are:

1. The need for all agricultural shippers, and for that matter all shippers, to have the right to reciprocal switching at reasonable cost. Under current law, as interpreted by the Interstate Commerce Commission, reciprocal switching arrangements may be canceled arbitrarily, or switching rates frequently increased to levels which make alternative rail service unavailable.
2. Agricultural shippers, and for that matter all shippers, need joint line rates and routes between rail carriers whose lines intersect and join. Currently, the Interstate Commerce Commission, as interpreted by the Commission, permits a rail carrier to unilaterally cancel a joint rate and route. A single rail carrier may therefore deprive many agricultural shippers from markets that would otherwise be geographically accessible to them. A rail carrier can combine the market power with strategically placed contract rates to effect wholesale diversions of grain from shippers and rail lines that would otherwise originate shipment of such grain.

Let me give you an example of why it is so important for an agricultural shipper to have the right to obtain reciprocal shipping at a reasonable cost. The terminal elevator facility that we operate in Wichita, Kans., is physically located on the Burlington Northern Railroad. It is approximately one-half mile from the physical interchange with the other rail carriers that provide service generally to shippers in Wichita: the Santa Fe, the MOP and the OKKT.

We receive in-bound shipments of grain for transit storage from each and every one of these rail carriers. Transit privileges are granted either by published tariff, or by contract with an agricultural shipper, and permit the shipper to plan a freight move from point of origin to point of destination with an intermediate stop for storage. Therefore, grain which enters our terminal via the Santa Fe will leave on the out-bound move on the Santa Fe as well. However, the switching of cars at our facility is performed by the BN because the facility is physically located on the BN's lines.

Over the last 4 fiscal years of operation, which end March 31 of each year, our records show that we have used all four railroads for the following percentages for our in- and out-bound moves:

[In percent]

	Rail carriers			
	BN	OKKT	MOP	ATSF
Fiscal year:				
1979–80	20	15	19	56
1980–81	26	22	20	32
1981–82	38	23	13	26
1982–83	24	10	18	48

As these figures indicate, over the past 4 years, the BN has handled approximately 27 percent of our in-bound and out-bound freight business; and the balance, 73 percent, has gone on other railroads. What these figures graphically show is that we are dependent upon the BN to handle and switch 73 percent of our business. Should the BN, for whatever reason, decide to increase its switching charges two or three fold, our business interest would be severely jeopardized. We would be left with the uphill struggle of challenging the rates as unreasonable. Under Staggers, a shipper will almost always have the burden of proving unreasonableness, even though he is deprived access to the cost data that is necessary to sustain this burden. Perhaps more importantly, however, the shipper must first make a threshold showing of "market dominance" to even obtain ICC jurisdiction to determine reasonableness of the rate. Given the current attitude of Commission members, as evidenced by the decisions permitting the unilateral cancellation of joint routes and rates and the abandonment of profitable agricultural branch lines, all in contravention of the public interest, I feel having this so-called remedy is no remedy at all. Shippers need to have the ability to challenge the reasonableness of rates that threaten their livelihood.

The second need that agricultural, and for that matter all shippers need, is the ability to utilize joint rates and routes to markets that are geographically within reach and which must be reached if the shippers are to remain competitive in their industry. The best example that I can give you of this need is to refer to our facility located in White City, Kans.

White City is served by the Cottonbelt Railroad, which is part of the old Rock Island Tucumcari to Kansas City line. If I want to offer grain for sale on the Gulf market, I cannot get there on the Cottonbelt. I can route my traffic on one of several combinations of the Cottonbelt together with other rail carriers that serve the Gulf. For instance, a logical choice would be to route Cottenbelt to Herington and then to the Gulf by the OKKT. Other possibilities include routing the Cottonbelt to Topeka and then via the Santa Fe to the Gulf; or Cottonbelt to Kansas City and then out via the KATY or Kansas City Southern.

Between November 1982 and March 1983, we were quite successful in shipping grain by a joint rate and route from White City via the Cottonbelt to Herington, and then via the OKKT to the Gulf. In fact, this has been our best competitive rate and route to the Gulf. However, the continued existence of this rate and route depends upon cooperation between the railroads. Under ICC interpretation of Staggers, that joint rate and route could be cancelled unilaterally at any time by either the OKKT or the Cottonbelt.

While unilateral cancellation is enough of a threat to competition, the problem becomes compounded when you super-impose upon this example the existence of a rail freight contract with a nearby shipper located on the line of one of the carriers participating in the joint rate and route. In my White City example, we rely upon the continued cooperation between the Cottonbelt and the OKKT to maintain the joint rate and route. However, the joint rate and route is currently being maintained but is no longer competitive. We believe the OKKT has entered into a contract with a shipper in Herington, which is 14 miles from our facility in White City. You have heard testimony today about the tremendous drawing power that contract rates have. At White City, we had felt the effect of a contract in effect at Salina. However, since late spring or early summer, we have been impacted by a contract rate only 14 miles away. While the joint rate and route we previously used has not been cancelled, one could say that there has been a "defacto" cancellation because it is no longer competitive with a single line haul contract rate. But remember, it had previously been competitive with the single line haul published tariff on the OKKT from Herington.

Since the Commission has decided that Staggers does not require that the essential terms and provisions of the contract be disclosed publically, I can't say with any certainty that what level that contract rate is. I suspect that it is at least 10 cents per bushel below the published tariff that was in effect prior to its implementation. I simply know that before the contract rate was established, we were competitive from White City using the joint rate and route. We lowered our margin to make up for the freight difference generated by a two line haul. Now we are not competitive and the contract rate is the reason.

I might understand the differential created by this contract rate if it were justifiable by some efficiency or volume that only the Herington shipper possessed. But in fact, the rate cannot be rewarding that Herington shipper for any particular economy or efficiency attributable to volume. The facility is one-half the size of ours in White City; and has less loading capacity and less efficient loading capabilities than our facility which can load 9 cars and has side track for a 25-car unit.

I have heard the entire purpose behind "deregulation" in general, and deregulation of the rail industry in particular, was to promote competition. If that was the aim of the Staggers Rail Act, I submit to you that it has missed the mark and missed badly. The combination of a railroad's ability to unilaterally cancel a joint rate and route, when considered in tandem with a railroad's ability to "buy" traffic by using the contract rate provision of Staggers, can be, and is being used by some railroads to deprive other carriers of traffic that can be and would be handled by them. By permitting the unilateral cancellation of joint routes, one railroad can preserve a single line haul, even if it means inefficient routing on that single line and depriving agricultural shippers located on other rail lines from geographic markets.

The contract rate provision can be used by a railroad to obtain a "de facto" cancellation of a joint rate or route. If the contract is advantageous enough to attract grain produced outside the contracting shipper's normal trade area, no grain shipments are going to originate from the other shippers on the competing line; it will all be captured by the favored shipper for origin by the contracting carrier.

To sum up, I think you need to take a long hard look at Staggers, now 3 years after its enactment, to see if the objectives that Congress had in mind are being achieved. I submit to you that they are not. The problems that are being encountered under Staggers, such as those related to reciprocal switching and unilateral cancellation of joint rates and routes are having a disastrous impact on agricultural shippers. I have briefly touched upon the contract rate provision, solely as it complicates and compounds the problems that exist with regard to joint rates and routes, however, I have talked with other members of the panel about the problems that they have experienced in trying to compete with these contracts and I can tell you my company has the very same problems with contract rates.

I don't know much about our antitrust laws, but I always figured it was unfair and illegal to use monopoly power to divide and allocate markets and to using pricing power to eliminate competition. In my mind, this is exactly what contract rates have permitted. I just don't believe that contract rates, and other aspects of Staggers has promoted competition—it has destroyed it.

I hope you can make this the first of several hearings of this type. As a director of the Kansas Grain and Feed Dealers Association, I can tell you that we as an Association, have talked to thirteen other State Associations about forming a coalition to prepare and propose specific legislation that we feel would not amount to "reregulation", but would ensure that the problems we've discussed can be solved.

Senator **Kassebaum**. Thank you very much, Mr. Severe. Just like to mention, along with your several comments that have been made about other hearings, there is going to be a meeting here, I understand, in Hutchinson in September the USDA is sponsoring regarding grain transportation, which I think will be another opportunity to try and analyze some of the problems.

I would like to just ask one question. Then I think the burden of the examination may fall on the representatives of the railroads here, and I would like to hear the exchange and the analysis that will come from your comments on the testimony because I think that will shed more light on any solutions that we need to look to, perhaps, than the questions I might ask. But you heard from the representatives of the railroads earlier that indeed full disclosure might mean the fact that there would just be no contracts offered. What effect would this have on your business if there were no contracts? Do you see this then as causing chaos in the marketplace? I assume you do not think so.

Mr. **Severe**. That was going to be my first comment. I first do not believe that disclosure will conclude any contracts ever being made. I do not believe that for a minute and I really do not think the railroad people believe that either.

It seems to me that they have wanted to imply that as long as they could have complete secrecy they could continue to develop efficient contracts between people and shippers on their lines, but without complete secrecy they cannot. Well, I do not believe that. First of all, I do not believe even with the secrecy law in the Staggers Act, I do not think there is all that much secrecy that goes on. What I have seen or at least experienced is it appears to me that when the railroads do find out either by casual comment or some other method of knowing that one railroad has got some sudden advantage over the other railroad, they all of a sudden take real quick action to become more efficient and so they then too can be involved in this new movement of efficient traffic.

Senator **Kassebaum**. So you really all believe that full disclosure would be one of the best things that you could get at this time to be continually competitive and stay in the market, so to speak?

Mr. **Henrickson**. May I answer that, please?

Senator **Kassebaum**. Mr. Henrickson.

Mr. **Henrickson**. No; I do not believe it will solve the problem at all, but you still have contracts as compared to published rates, and there is no equality there at all.

Senator **Kassebaum**. But published contracts, full public——

Mr. **Henrickson**. Full published contracts still give certain shippers tremendous advantage over the rest of us that have to ship by published.

Senator **Kassebaum**. And if you could show, however, that there were discriminatory rates and make that appeal to the ICC, is this something that you believe you would do if you could?

Mr. **Henrickson**. Those country elevators that could afford to do that possibly would, but there would be a great many that it would be an impossibility for them to handle the costs of such a procedure.

Senator **Kassebaum**. I would like at this point to have the railroads' representatives comment on some of the testimony we have heard so far.

Mr. **Steiniger**. Senator, with regards to the panel, of course I met John before, that is the one elevator, of course, the OKT has the opportunity of serving. I might say this, and I know your relationship with Kansas Feed & Grain, I might say a number of our grain transportation contracts are also with those members of Kansas Feed & Grain, so obviously there are people that belong to the same Kansas Feed & Grain Association that the contracts are beneficial to. I can't say, nor can I state enough, that for the OKT-MKT, that has been one of what we would consider perhaps positive events from the Staggers Act as a smaller regional carrier, has been the grain contracts. After all, I looked, I think this morning, after indicating to the Chairman of the Commission that our protests with regard to the cancellation of joint routes and rates have been summarily dismissed. The grain contract is one of our only vehicles as a smaller carrier to survive in the traffic and to be competitive both intramodally and intermodally. Thank you.

Senator **Kassebaum**. Well, if that is so, Mr. Steiniger, then why would full disclosure be a problem?

Mr. **Steiniger**. Because, Senator, once again the full disclosure of the contract and the terms to me would negate the business proposition. I think the fact that you would set out and disclose exactly what the rates are going to be, as a result, with that particular competitor knowing, I think it is going to be short lived with regard to a contract.

Senator **Kassebaum**. Have you ever been involved in contract negotiations with, say, Mr. Severe?

Mr. **Severe**. Pardon?

Senator **Kassebaum**. I just wondered if Mr. Steiniger had ever been involved in contract negotiations with you.

Mr. **Severe**. The answer to that is no.

Mr. **Steiniger**. No, he has not. I believe, if I am not mistaken, Mr. Severe may have been approached by one of my grain pricing and marketing officers, such as Ronald Smith or Art O'Mary.

Mr. **Severe**. Let me respond to that, Senator. The particular case that we talked about here is—remember, my elevator at White City is not on his line, it is 14 miles from his line. So I cannot negotiate a contract with him 14 miles away unless he is willing to come to White City and pick up the grain, then I would talk to him.

Mr. **Steiniger**. Of course, I think, Senator, in this case we are really referring to the Wichita arrangements with John. We would be more than happy to sit down with you and talk to you on a grain contract.

Mr. **Severe**. Let me respond to that, too. As most of you know, and I doubt that the Senator does, I am probably one of the smaller terminal elevator facilities in Wichita, and survival for the small guy anywhere is not all that easy today. I could very well sit down and negotiate some kind of a contract with your people, I feel, or at least there has been some overtones of that, but once I do that, I alienate myself with the Burlington Northern, the Missouri Pacific, and the Santa Fe, and remember, 73 percent of my livelihood comes from other routes. So I believe the two points are still very clear that reciprocal switching, which is my life's blood in Wichita, and contract rates do not solve my problems, it only would complicate those problems.

Senator **Kassebaum**. Mr. Henrickson, did you want to ask a question?

Mr. **Henrickson**. Yes.

Senator **Kassebaum**. Mr. Runnalls?

Mr. **Runnalls**. I had a question here as to what would be the smallest number of cars loaded that could be contracted.

Mr. **Steiniger**. Well, I will speak only for the OKT-MKT, Mr. Runnalls. Many of the elevators that I have mentioned before with regards to their location on the OKT-MKT are sometimes only one-car and two-car spots. In fact, I can only recall from memory right now one or perhaps two possibilities where we can load 75-car units. What we try to do is tailor that particular marketing package to the needs. As I mentioned earlier, it has been very successful in getting us back into a market with regards to grain that had moved truck-barge. I heard this morning many times over and over again about the truck situation, and I am speaking to you as a small carrier, this has been an area which we have used as our life's blood of going out and maintaining our market share in the grain area, and it has been successful, gentlemen, very successful.

Mr. **Colvin**. Mr. Runnalls, I would like to ask whether at any point in time you have in fact approached the Union Pacific-Missouri Pacific for a contract. You mentioned the 25-car spot and the $75,000 investment, which I feel is meaningful and certainly warrants communication. I am told by our grain marketing people that we are not in fact contacted very often by the small country elevator operator for contracts to fill certain needs. We in fact do make every attempt to insure that the small operator is competitive in the marketplace. That is our function in marketing. We want to insure our handling of as much grain as possible, whether it be through the country elevator or high speed terminals.

Mr. **Runnalls**. Well, most of the time the 25-car published rates that we have now is only good to the west coast, and of course that is not always the best market. We are on the Union Pacific now. We have not asked for a particular contract rate primarily because it is usually given to the terminal more so than the country elevator because of the capabilities of loading. Like I said prior, it always had to travel over the rail line that went by our facility.

Mr. COLVIN. I understand you are in fact local on the Union Pacific and they of course did not serve the gulf in the past. We currently do as a new merged system and we would be delighted to talk with you further about those opportunities to the gulf.

Mr. RUNNALLS. That would be fine.

Senator KASSEBAUM. Do you evaluate in your contract negotiations the loading facility? You mentioned that, and I assume that is part of the efficiency or the competition that would have to be evaluated. Is that right?

Mr. COLVIN. Yes, Senator. The 25-car capability at one time implies certain economic savings in the railroad industry. That siding alone and the capability of loading 25 cars at one time is attractive to us.

Senator KASSEBAUM. Obviously of course some simply cannot afford to do that. But I would like to hear any of you comment. I would assume all three of you would say that it would not be to any real advantage to see the small elevator operators disappear.

Mr. STEINIGER. I better pass this to Don here. He is getting a little disturbed. From the OKT–MKT standpoint, once again, the bulk is the small country elevator, whether it is on the MKT siding or the OKT siding. Obviously that has not stopped us from sitting down with the country elevator and negotiating a contract. Once again, we have been very successful with it.

Mr. FINLEY. Thank you. Part of the problem that everyone is faced with is a function of the marketplace and the grain-marketing practices that have been built up over the years is as much a part of it as the Staggers or a published rail rate or anything else. If I could ask a question, and I think I could go on. Sherm, when you sold your grain, your wheat, in May 1983, what was the basis on which you sold it?

Mr. BAIRD. It was a gulf basis.

Mr. FINLEY. It was on the gulf basis. That gulf basis included the delivered price at the gulf. That rail rate to the gulf is in the neighborhood of $1.40. The $1.18 and the 58 cent had nothing to do with the sale that he made in May 1983. Practically all wheat sold in Kansas is sold on the basis of gulf delivered or Kansas City delivered. That is a very important fact to remember. OK.

The illustration that was shown is a perfect example of what contracts can do in the marketplace. In explanation, I may be revealing some confidential information, but I think it is important. The party at Wellington, while he has storage facilities, is primarily a flour miller. The trucking costs from the Garden City area to Wellington was 58 cent a hundred. So we were desirous of capturing that truck movement from the Garden City area to Wellington so that we could therefore participate to a greater degree in a separate contract on the outbound flour movement which had also been lost to trucking. We could not compete on the $1.18, but by giving him a contract to move the wheat to be competitive with trucks, it would require that freight bill to be a part of the outbound movement, we were able to capture two movements, not one but two. Again it is a perfect example of what contracting can do in the marketplace today, and it had absolutely nothing to do with the net end price that Sherm received on his wheat.

Now, where he was out some additional money was on the inbound move. The terminal operator, as they all do, charged him back while it was in storage the $1.18. He had to pay interest on that $1.18 where on the contract would only have been 58 cent. That is a difference in what his net was. But as far as the sale of the grain was concerned, there was no difference at all.

Insofar as shortage of cars during the harvest, that is a peak period demand, and particularly this year, almost from at least the Red River of Oklahoma to northern Kansas, within about a 2- or 3-week period, the harvest was all over in this area. It would be physically impossible, if in fact it would be financially possible, to furnish every single car to meet all the needs. On the Santa Fe, we have a way to get around that. Also, it is very important to note that this procedure is counted toward the revenues on a branch line. We have a truck allowance system which in fact this year we foresaw what was happening and for June and July I increased the allowance by 5 cent a hundredweight so that they could be more equitably reimbursed for substitution truck movement into terminal, tendering it as a rail shipment, and they would get all the benefits that is associated with the transit.

I assure you, those revenues that that allowance would generate is charged to the branch line. I am on the branch line committee of the Santa Fe, and we do not abandon any branch line if it is profitable or if there is any way we can see that it is profitable.

Insofar as Lorraine is concerned, the Burlington Northern have approached us about their possibility of filing for abandonment and asked if we would consider purchasing it, and they were told yes. That is one of our most profitable branch lines, and we want to see that we retain it that way.

Senator KASSEBAUM. Thank you. Mr. Baird, do you have any particular comments?

Mr. BAIRD. Well, Don of course is right in the eventual sale of grain that you have in store, in our area it is based upon export basis and the through rate from our point of origin to our export house. I think my point in bringing out such an illustration was to illustrate the unfairness of the competitive position that contract rates cause. First of all, I was furnishing 60 cents a hundredweight to that terminal elevator as operating capital within his operation. I shipped at that period of time 500,000 bushels of wheat, and that would amont to about 36 cents a bushel on that 500,000 that I was providing that terminal elevator operator with, when we in fact at that time were paying interest on borrowed funds at probably 14 to 14½ percent. So my point in illustration was it is an unfair competitive advantage because I have interest costs that I have to overcome through my gross margin picture.

Now, I was interested in one comment that Mr. Finley made, and that was contract rates with small country elevators. I was quite well pleased to hear that because up to this point I was not aware of any contract rates with small country elevator operators, particularly on the Santa Fe.

Senator KASSEBAUM. I was going to ask if you had negotiated yourself for any.

Mr. **Baird**. No; we have not. We have discussed with Santa Fe people contract rates, but up until recently evidently they did not elect to give country elevator operators contract rates but primarily direct their attention toward the terminals and the subterminals.

Senator **Kassebaum**. Why is this so?

Mr. **Finley**. People problem, just lack of enough people to make the contacts for the contracts. They are very time consuming, and as you get into the market to find out what is going on and you start reacting to this and making your contracts, it is a nature of any business to protect your largest moves first.

Now, we made our contracts, we have some 15 or 16 contracts that specifically apply from country to terminal to gulf, and they were designed for the benefit of the country elevator operator. They were also designed to take care of some terminal problems but they were destined to protect this total rail movement through the marketplace. If anyone has a need for a specific situation, we are willing to work that out. We have one field personnel located in Hutchinson, Howard Howtan, who knows most of the people we serve, and we are now getting to the point that we are dealing more with the country people than we have in the past. But I need to emphasize our contracts were specifically designed to perpetuate them. I just cannot emphasize too strongly our feeling that the country elevator is our lifeblood in grain. If we do not have them, they do not have us, and it is a mutual thing. The branch lines, I know there is sometimes some advantages to trucking over, but basically a branch line, people on branch lines, they hold their future in their own hands. The more they truck, and I can understand wanting to pick up another 4 or 5 cents a bushel, then that is taking traffic away from that branch line and revenues that could go toward its upkeep and its operation. Again, I just cannot emphasize the country situation enough.

Senator **Kassebaum**. Would this be true for the Union Pacific as well? Is this your philosophy as far as entering into contract negotiations with the elevator operators?

Mr. **Colvin**. Is that——

Senator **Kassebaum**. Has it just not been done because there has been a shortage of people?

Mr. **Colvin**. In part, that is true.

Senator **Kassebaum**. Pardon me just a minute. Are you approached? I mean is this something that on the part of the elevator operators you have made these efforts in the past?

Mr. **Runnalls**. Correct.

Mr. **Colvin**. I personally have not been approached that often, although I am not actively involved in the marketing of grain today. In discussing this issue with our marketing people, they contend that the approach has been quite sparse up to this point in time.

I agree with Mr. Finley, it is in our interests obviously to protect the country elevators, to protect the storage that is available out there, to protect the services that they perform. That is our goal in the marketing approach. I agree more needs to be done. I think communications need to be more open. We need to begin to talk more frequently than we have in the past. We and the Santa Fe obviously have first addressed the large terminal operators initially, the huge flows of grain, the highly competitive market that exists at those points, but we do in fact intend to address the country elevators as well.

Senator **Kassebaum**. Mr. Henrickson, for instnace, have you ever been involved in a contract negotiation or made a request to do so?

Mr. **Henrickson**. Not as of yet. We have done considerable investigation as to what was entailed, what procedures we would have to take. We were not encouraged by our last letter from Mr. Clamberg before he retired and the last visit to even enter into a contract rate. Since then, I have had no one call on me to entertain such a proposal.

Mr. **Severe**. Senator, I would like to addres that if I may. As a small terminal shipper and also a country elevator shipper, but small being the key word, most of us have been led to believe through hearsay or common gossip that most of these contracts that are currently being made, the ones that have been testified about, are large volume contracts that a lot of us could not manage to meet the requirements in volume regardless of the situation. So I think to ask these men, a lot of them would have to be reluctant to enter into those negotiations for fear of their volume, even as anticipated, may not turn out that way because of frost that you have heard testified to or drought or whatever. So it is not easy for the small independent person to enter into the same kind of contract negotiations as would be with the large multinational corporations.

One other comment that I would like to make and then I will be still is I thought it was particularly interesting in Mr. Finley's comment particularly in regard to the fact that the railroads all believe that disclosure of rates would be very unhealthy for the railroads. In the comment about the $1.18 rate out of——

Mr. **Finley**. Pierceville.

Mr. **Severe**. Yeah, Pierceville to Wellington. Mr. Finley stated that because he was aware that there was a 58-cent truck rate out of that area into Wellington, then they developed a contract rate so they could be competitive with the trucks. So to me that is just very good testimony that maybe disclosure is better than they want to admit.

Senator **Kassebaum**. Thank you.

Mr. **Finley**. The $1.18 is necessary on a normal transit move to insure that that grain stayed on the Santa Fe. If it was a constant 58-cent rate that had to go into the transit house, then there would be the availability for a truck-barge situation from Wichita to Tulsa or one of my colleagues to file a contract to the gulf, it would force them to throw that inbound freight bill away. We want to provide a full service for the people we serve from the country to terminal to the gulf or wherever the consumption is going to be on the wheat, and so the higher rate is necessary to protect our interests as well as theirs in that move. Again, I emphasize that example as a prime example of the Staggers Act in action.

Senator **Kassebaum**. Mr. Baird, I would like to ask you on that because that affects you, you indicate. Is that not right?

Mr. **Baird**. Yes, ma'am.

Senator **Kassebaum**. Knowing full disclosure of contracts, and I assume you knew perhaps why there was that differential, is that right, you knew that before today?

Mr. **Baird**. No; I found it out today. It was quite by accident that I even found out about the contract rate which I assumed to be a contract rate when they inadvertently sent me two copies of freight bills that I was not supposed to see.

Senator **Kassebaum**. Well, let me ask, if you had known, and obviously this is a disadvantaged to you, how would you have combated it, what could you have done to have given you a competitive participation?

Mr. **Baird**. I think under the environment at that time, there probably would not have been anything I could do. Had they published contract rate disclosures, I still would have been subjected to the posted public tariff, so there really would not have been anything I could have done at the time under that particular environment because I am a captive shipper. We have the Santa Fe as our only way out of there as far as rail transportation, and when we look at volume, there is no other way we can go because with the eight elevators we have, we have the capabilities any 1 day of moving in excess of 200,000 bushels of grain. During harvest when it is short and fast, we have done this. It would take 200, 300, 400 trucks a day moving out of our facilities. The reason I am interested in Don's statement that they will make contracts with country elevators, I assume that their contractual agreements is where they are experiencing most competitive situations, and this would be with other railroads where they are close by and people have an alternative as to where they can go. We are a captive shipper, and at the time the only thing we could do and we did do, and that was contact the railroad officials and the terminal facility that we were shipping to as to why the disparity between the two rates and raised a little heck with them.

Senator **Kassebaum**. I would like to say, unless someone else has a particular question you would like to raise at this point, I think some very thoughtful testimony has been given and some very important points raised. I am sure that everybody in this room realizes, and I do not know that it is a totally objective audience, but we are here because we share concerns about this, that we need to try and take another look, and that is the purpose, of course, of the oversight on the Staggers Act, to see if indeed we can answer some of these concerns. Successful, healthy grain transportation is important to the railroads, it is important to our smaller communities, it is important to the economic well-being not only of Kansas but of the country. I think as we consider what might be of advantage in the ways of legislative endeavor, this particular hearing here this morning has been one of the most useful that I have heard certainly in the 2 days of full hearings that we have had on oversight of the Staggers, and I think partly it is because there has been a willingness to exchange and share this information and to question each other in a way that helps us to understand what some of the problems may be. Thank you. Jan, do you have anything?

Ms. **Rosenak**. No.

Senator **Kassebaum**. I would like to thank also Chuck Doyle of the Commerce Committee staff who advises me on transportation matters and certainly Jan Rosenak and Gail Gibbons for being with us this morning and for Chairman Taylor and for all who participated. Thank you very much.

[Whereupon, at 12:55 p.m., the hearing was adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF THE AMERICAN IRON & STEEL INSTITUTE

The American Iron and Steel Institute is the principal trade association of the steel industry of the United States. Its membership includes 59 domestic steel companies which represent about 86 percent of the raw steel production capability of the United States.

Due to the nature of the iron and steel industry, its products and shipping practices, AISI members depend upon reliable rail service. Raw materials such as coal, coke, limestone, iron ore, and scrap move to AISI member plants, and large quantities of steel products are transported to customer plants, by rail.

The Staggers Rail Act of 1980 was the legislative response to a perceived secular decline of the railroad industry, attributable, at least in part, to federal overregulation. It was felt that the provisions of the Interstate Commerce Act were excessively restrictive, inhibiting the ability of railroad managements to conduct their affairs effectively. Many uneconomic services and lines were continued due solely to regulatory requirements. Carrier managements were unable to adapt their pricing practices to changes in market conditions.

In substance, it was generally believed that the railroad industry should be relieved of many regulatory constraints and, being exposed to competitive market forces, should be allowed to manage its affairs in this freer environment. The American Iron and Steel Institute concurred in this general philosophy and participated in drafting the statutory language of the Staggers Act. We wished to see, however, that the Act was drafted in such a way as to balance the interests of railroads and shippers, and that the Interstate Commerce Commission in interpreting and applying the statute gave full recognition to this necessary balance.

AISI agrees that competition, when it exists, is a better regulator of carrier actions than are the dictates of an administrative agency. However, we also recognize that the economic characteristics of the rail industry did not always assure that competitive conditions will exist. The uniqueness of railroads as compared with motor carrier and barge operators is that the former own and operate their own rights-of-way on an exclusive use basis, while the latter utilize public thoroughfares. We believe that this characteristic of "exclusiveness" in the railroad industry could, in the absence of any regulatory limitations, prove to be anticompetitive (1) in relationships between carriers and shippers, and (2) in relationships between carriers themselves.

The first manifests itself in the "captive shipper" situation wherein a transportation user finds himself with no economic alternative to rail transportation or even to the use of a particular railroad. In such a situation, the absence of competitive restraints on railroad rate making required that the Staggers Act incorporate limits on the reasonableness of rail rates established under these conditions. For this reason, the Act does contain provisions imposing some such restraints, usually framed in terms of a percentage of variable cost.

As to the relationships between carriers themselves, the Staggers Act clearly recognized the possible tendency toward anti-competitive practices by individual railroads. This would manifest itself in the areas of route cancellations and the reduction or elimination of reciprocal switching. To address these possibilities, the Staggers Act contained provisions establishing or modifying Sections 10705(E), 10705A and 11103(c)(1). Under these provisions carriers were permitted either to surcharge or cancel those specific routes via which economic revenue divisions could not be established. On the other hand, to enhance competition, carriers were also discouraged from reducing or eliminating reciprocal switching. In fact, the Commission was empowered to require rail carriers to enter into reciprocal switching agreements where it finds such agreements to be practicable and in the public interest or if such agreements are necessary to provide competitive rail service.

In substance, Congress agreed that greater reliance on competition, as opposed to regulation, was desirable, but also established safeguards to inhibit anti-competitive actions by the railroad industry. It was left to the Interstate Commerce Commission to implement these directives.

Both prior and subsequent to the enactment of the Staggers Act, a parallel economic development in the railroad industry was taking place which continues to have a profound effect on competitive relationships in that industry. This development is the significant concentration of economic power resulting from the ongoing railroad merger movement. In something more than two decades, we have seen the number of Class I railroads decline from 130 to 24, with no indication that further concentration will not take place. We have now reached a point where seven railroad systems originate 81 percent of the nation's rail freight. In light of this substantial and growing concentration, it becomes increasingly important that the procompetitive provisions of the Staggers Act be aggressively implemented.

Unfortunately, recent experience indicates that the Interstate Commerce Commission is increasingly reluctant to follow its Congressional mandate in this area. First in Southern Territory (Family Lines-Southern), then in Official Territory (Conrail-Chessie), and now in Western-Transcontinental Territories (Southern Pacific-Santa Fe-Union Pacific), a disturbing if not ominous pattern appears to be forming. In each case, carriers have taken action to cancel existing joint-rates/though routes and, in retaliation, other carriers have cancelled reciprocal switching arrangements. These routes cancellations have not been individual selective eliminations made after an analysis revealed that divisions via these routes did not yield revenues exceeding 110 percent of variable cost. Rather, they were massive, territory-wide cancellations, effectively closing many economically viable gateways important to the trade, commerce, and defense of this nation.

Section 10 of the Staggers Act states, among other things, that it is "the policy of the United States Government . . . tc allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail;". . . and "to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers."

We think this clearly shows that Congress intended the new freedoms granted the railroads to be exercised in a manner that did not result in the elimination of competition. Since competitors cannot be expected to act in such a manner without some outside control, Congress not only stated its policy but gave the Interstate Commerce Commission the power to promote continued competition.

For example, the provisions of Section 10901(a) of Title 49, United States Code, which formerly required the Commission to find that "public convenience and necessity require or will be enhanced by the construction or acquisition (or both) and operation of the railroad line" were changed to read "public convenience and necessity require or permit the construction, etc." Language was also added to this section which forbids another railroad from blocking the new rail line once it is authorized by the Commission. Section 11103 of Title 49, even prior to the Staggers Act, gave the Commission the power to require the granting of trackage rights in terminal areas. The Staggers Act, however, specifically added language to this section giving the Commission the power to require reciprocal switching "where such agreements are necessary to provide competitive rail service."

The recent route closings and retaliatory cancellations of reciprocal switching are the natural acts of the railroads operating under the new Staggers Act freedoms. The route closings promote efficiency while shutting off competition. The cancellations of reciprocal switching are strictly anti-competitive. The Interstate Commerce Commission clearly has the right and the obligation in this situation to use its powers governing new rail construction or acquisition, trackage rights, and reciprocal switching to implement Congress' policy "to ensure . . . a sound rail transportation system with effective competition among rail carriers." Specifically, the Commission should act promptly and favorably on petitions for new construction or trackage rights to serve additional customers, thus increasing competition. Similarly, the Commission should require reciprocal switching at reasonable rates so that shippers have access to additional line haul railroads, thus promoting competition.

Despite this, however, the Interstate Commerce Commission has been exceedingly reluctant to exercise its administrative authority. Instead, the Commission, apparently feeling that Congress legislated almost total deregulation of the railroad industry under the Staggers Act, has permitted rail carriers to implement these obviously anti-competitive restrictions. The end result of the process is becoming clear. The national railroad network is becoming increasingly fragmented, important gateways and routes are being closed, service competition is being reduced, and competitive joint lines rates are being eliminated in those instances where a participating carrier can also provide single line service.

Our participation in and understanding of the legislative deliberations leading up to the enactment of the Staggers Act does not reveal any Congressional intent drastically to reduce intramodal competition. Quite to the contrary, many regulatory restraints were lifted or eased in the obvious anticipation that competition would thereby be enhanced, not diminished. Refusal or failure of the Interstate Commerce Commission to understand and implement this legislative intent is directing our nation transportation system toward a period of serious difficulty and dangerous inadequacy.

We by no means suggest a reregulation of the railroad industry. The steel industry consistently advocated lessened regulation in areas such as liberalized line abandonment, authority to establish rate and service contracts, discontinuance of uneconomic services, improved pricing flexibility and many others. However, we advocated this in anticipation of increased competition, both intermodal and intramodal. What is now occurring is contrary not only to our anticipation but also to what we perceive as Congressional intent.

The current route problems arose because of the Staggers Act freedom and, while the Act contains some directions for solving those problems, the Commission needs additional instructions and tools in order to accomplish Congress' intent. Specifically, the Act should be amended to broaden the Commission's authority to provide trackage rights, to prohibit cancellation of reciprocal switching where it is practical and competitively necessary, and to prevent cancellation of joint routes prior to an investigation which finds that intramodal competition does not require a joint rate.

In addition to the rate/route reciprocal switching cancellation problem, another area of concern, which requires legislative correction, relates to the matter of rate escalation permitted in response to changes in the Railroad Cost Recovery Index. Section 10707a(b) of Title 49, United States Code, permits rail carriers, through general increase proceedings, collectively to increase rates to recover cost increases reflected in the Commission-approved cost index. However, no provision is made for general reductions in rates when the Index indicates that a cost decrease has been experienced.

Since the basic thrust of the Staggers Act was to improve the financial condition of the railroad industry and since, at the time of its passage, no one seriously contemplated a sustained period of cost reduction, it seems quite natural that such an oversight would occur. However, recent experience indicates that measurable cost reductions do, in fact, occur. In fairness to the shipping public, such reductions should be permitted to modify general increases previously taken by the railroad industry. As an example, following are the RCCR Index changes that have taken place during the last five quarters:

	Percent
April 1, 1982	−1.2
July 1, 1983	+0.5
October 1, 1982	−1.0
January 1, 1983	+1.0
April 1, 1983	−3.1
Net change	−3.8

Despite the fact that during the most recent five quarters railroads have actually experienced a net cost reduction of 3.8 percent, they have been permitted to increase rates by 1 percent (effective January 1, 1983). This is an obvious oversight. To correct the inequity we endorse an amendment to Section 10707a(b) of Title 49 as follows: "To the extent that a rail rate has been increased under this subsection, or through (A) general rate increases pursuant to section 10706 of this title or (B) inflation-based rate increases under section 10712 of this title, the rate shall be reduced to the extent of any subsequent decreases in the adjusted base rate."

If total deregulation of the railroad industry is to take place, we believe it should follow extensive Congressional examination and debate followed by appropriate legislative enactments.

Potentially dangerous trends are developing which are disturbingly similar to those which precipitated the original Act to Regulate Commerce in 1887. Failure to address and correct these now can only result in the need for more drastic and tragically inhibiting legislation in the future. We would then repeat the cycle of abuse/overregulation which has characterized the past century. If the Congress addresses and corrects those actions which are patently anti-competitive now, the need for more drastic solutions in the future can be eliminated.

STATEMENT OF CHARLES W. BATH, VICE PRESIDENT—TRAFFIC, FARMLAND INDUSTRIES, INC.

My name is Charles W. Bath, and I am Vice President of Traffic for Farmland Industries, Inc., headquartered in Kansas City, Missouri. I have been in the field of transportation for 40 years and have headed Farmland's Traffic Division for 17 years.

Farmland Industries, Inc., is a regional farm supply cooperative owned by more than 2,300 local cooperative associations located in 19 midwestern states. Farmland supplies petroleum, feed, fertilizer, and other farm supplies to a half-million midwestern farm and ranch families through their local cooperatives and provides grain marketing services through its subsidiary FAR-MAR-CO, Inc., and meat packing and marketing services through its subsidiary Farmland Foods, Inc.

Farmland's total estimated transportation costs for fiscal year 1983 are approximately $600 million. Rail transportation accounts for 75 percent of Farmland's total transportation costs.

We do not want to see a return to burdensome regulation of the nation's railroads. However, we do believe that some legislative modifications are needed to the Staggers Act in order to further enhance railroad competition and protect captive rail shippers. Call it a "mid-course correction," if you will. The changes which we advocate are discussed in the following paragraphs.

Intramodal rail competition has been reduced or eliminated in many instances as a result of major rail carriers canceling joint rates and through routes and reciprocal switching agreements. To rectify the situation, we believe that legislation is needed to prohibit such anti-competitive cancellations. With regard to through rates and joint routes, the Interstate Commerce Commission should be required to make determinations, upon proper complaint, as to whether a proposed joint rate cancellation is consistent with the public interest. In making this public interest determination, the Commission must consider the intramodal competitive effective of the cancellation. Furthermore, if a joint rate is canceled, the law should require the canceling carrier to establish a reasonable proportional rate, to the canceling carrier's point of interchange, to replace the joint rate.

Concerning reciprocal switching agreements, it is our belief that competition could be enhanced through a two-pronged approach. First, the law should provide that the ICC must require carriers to enter into reciprocal switching agreements where it finds such an agreement to be practical and in the public interest or where such agreements are necessary to provide intramodal rail competitive service. Second, the law should prohibit the cancellation of a reciprocal agreement except under specified conditions where a determination is made that the cancellation will not eliminate or reduce competition.

Determination of rate reasonableness, railroad revenue adequacy, quarterly rate increases, etc., requires the use of various cost accounting approaches. Unfortunately, there are no uniform accounting principles that are utilized in making these determinations. As such, carriers and shippers hire cost analysts to review available data and present arguments on both sides of the issue to the Commission. In the end, the ICC's own Cost Section is likely to apply a different set of cost accounting principles. It is imperative that the Railroad Accounting Principles Board, as created in 49 USC 11161, be reauthorized and funded. 49 USC 11162 provides that the Board shall establish ". . . principles governing the determination of economically accurate railroad costs directly and indirectly associated with particular movements of goods or such other costs as the Board believe most accurately represent the economic cost of such movements." Until this Board is funded and its work completed, Commission decisions will be regarded as inconsistent and thus unfair.

Testimony has been provided before your Committee by the National Industrial Transportation League and The Fertilizer Institute. I am familiar with and endorse the contents of those statements.

In closing, we support carefully constructed modifications to the Staggers Act which would foster improved competition in the railroad industry and provide protection for shippers of farm supply inputs and agricultural commodities.

STATEMENT OF LEWIS E. BONNER, VICE PRESIDENT, ADOLPH COORS CO.

My name is Lou Bonner. I am vice president of Physical Distribution for Adolph Coors Company whose headquarters are located in Golden, Colorado. I have been vice president since 1981 and have been employed by Adolph Coors Company since 1967. During my entire tenure at Coors, I have been in the Transportation Department (organized as Physical Distribution Division, April, 1983) and am familiar with the transportation/distribution requirements and am authorized to submit this statement on the company's behalf. Adolph Coors Company is a brewer of malt beverage. In 1982, we ranked as the sixth largest brewer in the United States. We employ an average of 8,000 people and are engaged in a constant and controlled expansion program. Coors beer is currently distributed in 26 states by some 400 independent distributors and six company owned and operated outlets. In addition to the Adolph Coors Company, the brewery and parent company, Coors Industries consist of a group of thirteen wholly owned subsidiary corporations.

Adolph Coors Company sales in 1982 were about one billion dollars. Adolph Coors Company's total transportation expense in 1982 was about $100,000,000. Adolph Coors utilizes rail and motor carrier transportation to distribute products. About 75 percent of its transportation expense is for rail service. In 1982, we received 8,904 car loads of in-bound commodities and shipped 15,853 car loads from the brewery.

We are currently celebrating our 110th anniversary at Adolph Coors Company and are most proud of our history. We are extremely proud of our nation's history as well and we appreciate the evolution of transportation regulation by our Congress. We are pleased with transportation deregulation of 1980 knowing that it has been good for us and believe it has been beneficial for the public as well. Our thoughts today are pro Staggers Act. We do not predict a completely free competitive transportation system in the future, but we foresee some additional loosening of the restraints on competition within the general frame-work of existing regulation.

As I have stated, we think the Staggers Rail Act of 1980 to reform the economic regulation of railroads (and for other purposes) has been part of a natural evolution and is in the public interest. Regulatory and policy changes of this type will provide a better climate for the utilization and growth of presently known technology as well as the birth of new technologies. We have enjoyed the scope of management decision-making being expanded with the Staggers Act which has made us better managers.

We strongly believe in America's private enterprise system, and are encouraged by the results Staggers Rail Act has afforded us at Coors. The new freedom we have to make new rail rate and service contracts has afforded us many opportunities. We are able to use TOFC service at our convenience and rates are achieved by phone calls. One principal in-bound commodity, hops, is exempt and rates can be negotiated as needed. We have also enjoyed rate timeliness on regulated commodities. Nearly 80 percent of our outbound rail shipments move under rail rate or service agreements and we are pleased by the ability the Staggers Act has given us to negotiate rail contracts.

We believe the Interstate Commerce Commission and other economic regulatory agencies were designed to keep free enterprise alive and healthy in America. We understand that there cannot be a perfect system but we also believe the Staggers Rail Act of 1980 is very good and that it is needed to remain as legislated to keep our railroads alive. We do feel it is contradictory and even anti-competitive to lose various through routes and through rates which have been established over the years between and among respective railroads and we would urge this committee to analyze that area.

CONCLUSION

We are in a critical evolving period now. Institutional change is never easy. The valid concerns are that competitors lose business, communities lose services or prestige, labor loses jobs and politicians lose votes. We can anticipate with considerable certainty that transportation of tomorrow will be more complex than we know it today. We believe that transportation in tomorrow's world will be equally important as today. We trust that transportation will remain in the private sector, and we expect that motor carriers will continue to be the backbone of our transport system, that railroads will become relatively more important for many kinds of movements, and that inter-agency coordination and cooperation will exist. We understand that conditions of life require that we permit our government to regulate certain aspects of our freedom in order to prevent other people from infringing upon them. We support the (Interstate) Commerce Clause (1, 8, 3, of the Constitution). We appreciate the opportunity to express our philosophies; we hope that the challenge of the future will inspire you today to prepare and adapt to the future events that will be required for a better transportation system.

STATEMENT OF JAMES R. SMITH, CAJUN ELECTRIC POWER COOPERATIVE, INC.

My name is James R. Smith and I am the Executive Vice President and General Manager of Cajun Electric Power Cooperative, Inc., P.O. Box 15540, Baton Rouge, Louisian 70816. I present this testimony not in favor of any broad scheme to re-regulate the nation's railroads. Rather, Cajun wishes to identify a major area in which the free market is not operating in the rail transportation industry. That area involves shippers who are now subjected to rail monopoly power because of long-term supply commitments we made while relying upon pre-Staggers Act rail rate quotations. Cajun Electric and other shippers have lost many of the freedoms and flexibilities provided by the Staggers Act's rail contract provision (Public Law 94-448, § 208) and have been left at the mercy of rail carriers exercising monopoly power.

Cajun is a non-profit cooperative organized under the Rural Electrification Act (7 U.S.C. §§ 901 et seq.) engaged in the generating of electricity for wholesale distribution to its 13 member cooperatives. The member cooperatives, who are also non-profit organizations, distribute retail electric power to customers in 59 of Louisiana's 64 parishes. Cajun's members serve some 1,000,000 persons living in rural and suburban areas of the state. While Cajun's members do serve some commercial and industrial customers, the great majority of the members' customers are residential and these residential customers consume nearly 75 percent of the electric power generated by Cajun.[1]

Cajun initially purchased 100 percent of its electric power requirements from investor-owned utilities. As the demands of Cajun's members grew, however, Cajun deemed it advisable by the late 1960's to construct its own electric generation facilities. Cajun's first such facilities, placed into commercial service in 1972, were natural-gas fired, steam-powered facilities (Big Cajun No. 1). Cajun opted for natural gas because Louisiana is one of the most productive sources of natural gas in the United States. By the late 1970's Cajun needed additional operating capacity. By that time, however, federal energy conservation laws prohibited the installation of additional gas-fired units. The obvious alternative was coal, while federal environmental laws dictated the use of low-sulfur (as opposed to high sulfur) coal. The principal source of such coal is Wyoming's Powder River Basin.

Because of Cajun's need to expand its generation capacity, the construction of plants fired by low-sulfur coal was essential. This in turn required Cajun's entry into the Powder River Basin coal market in the late 1970's. Cajun's coal requirements and the uncertain nature of western coal prices indicated that Cajun needed to secure a stable supply of reasonably priced coal through long-term supply contracts with various mines. Cajun also would have liked to execute a companion rail transportation contract with the only possible carrier—the Burlington Northern. Such a contract would have ensured that once it had become contractually locked to specific sources of supply, it would not be hit with regular, astronomical rate increases by a monopolist railroad. Unfortunately, the highly unclear legal stauts of rail contracts in the late 1970's served as an insurmountable barrier to rail contract protection. It was only in 1980 that § 208 of the Staggers Act clarified the law of rail contracts and provided a clear avenue for coal shippers to protect themselves from such a scenario.

However, Cajun ultimately decided it could safely enter into the long-term supply contracts after extensive discussions with the Burlington Northern resulted in a quoted rate of $10.53 per net ton, to become effective on March 1, 1979. While this quote did not rise to the level of a contract, it represented both sides' view of a reasonable rate (profitable for the railroad without being exhorbitant for Cajun). Cajun thus went forward with its long-term supply contracts in reliance upon the representation that the BN would not take advantage of its monopoly power and suddenly raise the rate (beyond, of course, a normal escalation to cover inflation) after Cajun locked itself to specific sources of supply.

Unfortunately, in less than one year's time from the March 1, 1979 effective date the original $10.53 rate was raised by the BN three times, for a total increase of nearly 20 percent:

July 1, 1979	$11.38
November 27, 1979	11.91

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[1] Cajun's 13 member cooperative are: Beauregard Electric Cooperative,, Inc., Bossier Rural Electric Membership Corp., Claiborne Electric Cooperative, Inc., Concordia Electric Cooperative, Inc., Dixie Electric Membership Corp., Jefferson Davis Electric Cooperative, Inc., Northeast Louisiana Power Cooperative, Inc., Pointe Coupee Electric Membership Corp., South Louisiana Electric Cooperative Assn., Southwest Louisiana Electric Membership Corp., Teche Electric Cooperative, Inc., Valley Electric Membership Corp., and Washington-St. Tammany Electric Corp., Inc.

January 11, 1980	12.54

Since the middle of 1980, the BN has raised the rate an additional six times:

July 1, 1980	$13.99
July 1, 1981	15.91
October 1, 1981	16.13
October 17, 1981	17.14
June 12, 1982	17.95
January 1, 1983	18.13

The nine increases since March 1, 1979 accumulate to a total increase of 72.2 percent in a little over three years. this 72.2 percent increase (to $18.13) is especially shocking when an additional element is taken into consideration. The application to the $10.53 rate of (a) "Ex Parte" increases authorized by the ICC in 1980 plus (b) either Rail Cost Adjustment Factor, Consumer Price Index or Producer Price Index increases from the first quarter of 1981 through the second quarter of 1983 result in a "rate" of approximately $15.00—in other words, slightly more than half of the increase in BN has in fact applied. It must also be emphasized that Cajun has been forced to pay whatever the BN has demanded. Cajun's absolute dependency on western coal (and on the BN for the transportation of the coal) has forced Cajun to continue to ship the commodity over the BN despite the sky-rocketing transportation charges. When it is recalled that Cajun executed its long-term supply contracts—which guaranteed the BN a monopoly position—in reliance onthe railroad's 1979 price quote, the casual observer might well view Cajun as the victim of a "bait and switch" strategy.

Cajun is not coming to Congress in order to argue that the 4R and Staggers Acts be repealed or that the rail industry should be re-regulated. Cajun fully agrees that the free market is the best regulator and is quite willing to take its chances in the free market. However, there are situations in which the free markets simply does not operate. An example is where, in reliance upon railroad representations, a shipper commits to a long-term supply contract, effectively transforming the railroad into monopolist able to extract rates up to (but just below) the point at which the shipper no longer can move the traffic. In such a situation it is not enough to say that the railroad is entitled to a high market price based on the shipper's low elasticity of demand. The true market price is the rate (plus normal escalation) that was quoted to the shipper prior to its commitment to a single source of supply. The premovement, pre-supply contract quote constitutes the best measure of what rail management thought it could get and thought it would be satisfied with, under the circumstances that the shipper could still refuse and pull out with relatively little financial damage.

Cajun asserts that the Interstate Commerce Act should be amended in order to clarify that where a shipper entered into a long-term supply contract prior to the effective date of the Staggers Act in reliance upon a price quote made by a railroad with knowledge that the shipper would act in reliance, the reailroad's maximum entitlement during the life of the supply contract is the quoted rate plus normal inflation escalation.

STATEMENT OF DR. MARK COOPER, DIRECTOR OF RESEARCH, CONSUMER ENERGY COUNCIL OF AMERICA

Mr. Chairman and Members of the Subcommittee: My name is Dr. Mark Cooper and I am Director of Research at the Consumer Energy Council of America (CECA). CECA is a broad-based coalition of major national consumer, labor, farm, public power, rural electric cooperative, senior citizen, urban and low income groups (see attached list).

I appreciate this opportunity to give the Subcommittee the consumer point of view on the Interstate Commerce Commission's implementation of the Staggers Rail Act of 1980. At the time of passage of the Staggers Act, CECA cautioned that the protections it provided utility consumers were too weak and we urged stronger provisions. Arguing in support of the Eckhardt-Rahall amendment to the Rail Act, we maintained that: "[w]ithout the Eckhardt-Rahall amendment the Rail Act would cause dramatic, inflationary increases in coal and grain prices, a decrease in competition within the rail industry by forcing short lines out of business and a serious disruption of port activity by permitting railroads to discriminate against certain ports.

Little did we realize that the Commission would completely disregard even the minimal protections ultimately included in the Staggers Act, thereby creating an even larger potential disaster than we feared. As an indication of the problems with the Commission's approach, we will address the Commission's actions in ex parte 347, which would establish coal rate guidelines nationwide.

Throughout the proceedings that have been occasioned by the passage of the Staggers Rail Act of 1980, or which the Commission has chosen to undertake in light of that Act, the Commission has taken what we believe is a fundamentally incorrect approach to railroad regulation. The Staggers Act instructed the Commission to establish maximum rates for the transportation of coal with one eye on the viability of the railroads and the other eye on the impact that rate increases would have on captive shippers and national energy policy.

Section 203 of the Staggers Act states clearly the concern that the burden on specific commodities not be unreasonable:

"(C) In determining whether a rate is reasonable, the Commission shall consider, among other factors, evidence of the following:

"(i) the amount of traffic which is transported at revenues which do not contribute to going concern value and efforts made to minimize such traffic;

"(ii) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize the revenues from such traffic; and

"(iii) the carrier's mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier's overall revenues."

The House-Senate Conference Committee elaborated on the intention of the Act: "The Conferees intend that this policy include the encouragement and promotion of the transportation of coal by rail in accordance with the objective of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition."

Both Houses individually had expressed these concerns in the deliberations over their separate pieces of legislation. The Senate Commerce Committee intended that the test of reasonableness prevent excessive contributions from captive traffic:

"The rates on coal are of particular concern in view of the many substantial increases imposed on this traffic in the last several years. While recognizing that not all traffic can be transported at a fully allocated cost level due to competitive considerations, it is the Committee's intent that the Commission play an active role in insuring that such traffic bears its fair share of costs and that higher rated captive traffic is not unduly burdened. . . . .

"The railroads must improve their efficiency and cannot expect to achieve revenue adequaency by simply increasing rates which are already at a high level in relation to costs. The Commission is directed to continue to provide protection in such situations."

The House report is even more precise, expressing the intention that the Commission: . . . . give due regard to two things, whether a rate increase would mean excessive profits, and the need for a rate increase in light of the carrier's revenue position taking into account the policy of this Act that inadequate revenue carriers make adequate revenues. This language is not intended to imply that excessive profits for inadequate revenue carriers are reasonable."

Unfortunately, the Commission simply chose to close the eye it was suppored to keep on excessive coal rates and national energy policy. It has nelgected its legal and moral obligations to provide a balance between meeting the revenue needs of the railroads and moderating the impact of excessive rate increases—above all, coal rate increases. Through automatic fuel adjustment clauses, those increases translate directly and immediately into rate increases for the nation's electric utility consumers. Every assumption, every methodoloigical choice, every analsytic interpretation and, ultimately, every policy decision has operated to the advantage of the railroads and to the detriment of captive shippers and captive consumers. We believe that the Commission has erred in failing to take the interest of those consumers into acount.

The presumption on the part of the Commission seems to be that no matter how reckless the pursuit of revenue adequacy for the railroads becomes, there can be no harm done. Not only does such an approach violate the spirit and letter of the Staggers Act, it disregards a great deal of empirical, analytical and theroretical evidence to the contrary.

The ill-advised approach of the Commission has brought the nation's utility consumers to the brink of disaster. The Commission has, in essence, created a time bomb. It now proposes to explode that bomb in the form of a series of exorbitant price increases for coal transportation—increases of 15 percent per year above the rate of inflation every year for an average of eight years and, in some cases, more than a decade. These increases will immediately appear in the electric bills of households and businesses.

The conditions for these massive rate increases, whcih are to be set off by the ex parte 347 decision, have actually been established in other proceedings. The determination of maximum reasonable coal rates—the proposed 15 percent solution—is only the detonator that will ingite the explosive potential of earlier and concurrent decisions. In proceedings ex parte 393, ex parte 320, ex parte 290 and ex parte 346, the Commission maximized the explosive potential of the bomb—the burden that will fall on captive coal shippers—and targeted that potential by reducing the size of the class of captive shippers that would be forced to bear the burden.

The Commission's approach will not only place an awesome burden on electric utility consumers, it will prolong that burden because it encourages the worng solution to the economic problems that the railroads face. The Commission should minimize the need for differential pricing, while maximizing the role of efficiency improvements. The proposed approach to ratemaking will do quite the opposite because it allows, and therefore invites, huge price increases in coal rates which can be effortlessly achieved by the railroads. Efficiency will certainly languish while railroad take the easy, fast track to revenue adequacy by doubling or tripling coal rates.

In order to prevent this bomb from going off, the Consumer Energy Council of America, on behalf of electricity consumers throughout the nation, has called on the Commission to open its other eye and restore a modicum of balance to its approach to coal ratemaking. Failing that, we call on the Congress to force the Commission to follow the letter of the Staggers Act.

We believe that it is time for the presentation of the strongest case possible against the Commission's distorted approach and conclusions. We believe it is necessary to consider the conclusions one reaches if one reads the available theoretical, analytical and empirical evidence with the eye that the Commission has purposely closed. Such a reading of the record is logically as valid and morally as compelling as the reading which the Commission has given the record. Only after the Commission realizes that it must open its other eye can the process of integrating the two views into a balanced picture begin. Our comments to the Commission in ex parte 347 (Sub No. 1) represents our initial analysis of the failure of the Commission's approach. We enclose those comments and respectfully request that they be entered in the record.

In capsule form, our argument is as follows. We begin by establishing the broadest possible philosophical basis for restraint in coal rate increases. We point out that the Commission failed to take critical issues into account in its decisionmaking. Above all, the Commission has neglected the fundamental concerns that must be juxtaposed with the revenue needs of the railroads—the impact of coal rate increases on electric utility consumers and on national energy policy goals. These issues and concerns are raised directly in the Staggers Act and they are buttressed by general social and policy concerns. We conclude that the Commission must extend its time frame for achieving revenue adequacy and take measures to ensure a more balanced mix of contributions toward revenue adequacy from coal rate increases and efficiency improvements.

We go on to argue that the Commission's approach to the analysis of the revenue needs of the railroads has been improperly handled and that a proper test of revenue adequacy would show that it can be achieved well within the Commission's original time frame, but without the excessive coal rate increases that the Commission has proposed. We show that the Commission has measured revenue needs improperly and has chosen an ill-founded approach to filling those needs.

Finally, we argue that even if needs were measured properly and the general approach to meeting them were well founded, the approach that the Commission has taken to setting ceilings on coal rates is improper. We argue that the basis for its methodology is theoretically questionable, economically dubious, empirically intractable and socially unacceptable.

THE NEED FOR RESTRAINT IN COAL RATE INCREASES

Nowhere is the need for enlightened regulation more necessary than with America's railroads. Almost 85 percent of the coal transported by rail to utilities is moved under monopoly or captive conditions. Due to geographical or contractual restraints, these utilities have no feasible alternative method of receiving their coal. Captive shippers and ultimately consumers of electricity are at the mercy of railroads. Coal shippers are forced to pass along the higher costs charged by the railroads. These costs are paid for by the end user of electricity—the consumer. In the East, approximately 33 percent of the delivered cost of coal is the direct result of freight charges. In the South and West, the figure is a staggering 75 percent. Simply put, the railroads enjoy market dominance in the transportation of a vital energy commodity. Therefore, the Commission cannot permit the railroads to take advantage of their unique position and earn monopoly profits. The case for regulation is obvious.

The concern over the impact that these prices increases will have on consumers is intensified by the unique nature of electricity. Not only is it a necessity, vital to the health, safety and well-being of individuals, but, for many of its uses, it is a commodity for which there are effectively no substitutes. Not surprisingly, the Department of Energy has found that no more than 1 percent of the homes in the United States lack electricity. Thus, the extremely vulnerable position of the household consumer becomes evident.

The vital nature of energy and electricity, in particular, has been acknowledged throughout society. All levels of elected government officials have acted to protect the right of consumers to the most basic requirements for energy. Public opinion polls have shown that society as a whole views energy as a vital necessity and believes that consumption of basic amounts of energy should be guaranted to all individuals even if government must pay some of the cost.

Over the last decade, coal has contributed significantly to the national goal of increasing energy independence. To this end, the use of coal—a virtually inexhaustible national resource—has been promoted since the Arab oil embargo of 1973. The resounding success of this policy is evident in the utility sector in the period since the second oil price shock, when coal increased its share of total source energy from 42 percent to almost 53 percent and backed out over one million barrels per day of oil imports. Those gains could be severely eroded by unrestrained coal transportation price increases. Such a policy, which is essentially what the Commission espouses, is contrary to the national energy policy and the consumer interest in creating a more secure national energy future.

In addition, despite the increased reliance on coal, which competes in a market for substitutes (oil and gas) which itself reveals significant imperfections, coal still exhibits consistently lower prices than either oil or natural gas. In the past, this has been a boon to consumers. The Commission's proposal will wipe out this competitive edge.

RAILROAD REVENUE ADEQUACY

Railroads ought to be able to cover total operating expenses, to earn a reasonable return on their capital and to cover the cost of inflation to pay for new and old capital, as well as to provide a sound means of transportation for the nation. However, there is no economic rationale for allowing railroads to extract monopoly rents from captive shippers. By vastly overstating the revenue needs of the railroads, the Commission has literally written the ticket that will allow the railroads to do just that. A proper evaluation of adequacy must be made which will distinguish between railroads which are truly inadequate and those which are simply deemed inadequate by a faulty definition. Using their proposed new standards, the Commission found that 13 of 36 railroads are revenue inadequate. In contrast, the market valuation of the shares of each company and their respective financial ratios do not suggest ill health.

As a group, railroads out-performed a broad range of companies in 1980–82 (see Table 1) which constituted one-fifth of total industry sales (the railroads account for 1 percent of the total). The railroads' return on equity as a group was about 1.5 percent below the national average for those same years (see Table 2), but, given differences in accounting, which would affect these figures and which tend to underestimate earnings by railroads, they were probably right at the national average.

TABLE 1.—INDUSTRY GROUPS WHICH THE RAILROAD INDUSTRY HAS OUTPERFORMED

1980	1981	1982
Airlines	Airlines	Airlines
Appliances	Appliances	Appliances
Automotive	Automotive	Automotive
Building materials	Building materials	Building materials
Containers	Containers	Chemicals
Paper and forest products	Metals and mining	Containers
Retailing (nonfood)	Paper and forest products	General machinery
Savings & Loan	Real estate and housing	Metals and mining

TABLE 1.—INDUSTRY GROUPS WHICH THE RAILROAD INDUSTRY HAS OUTPERFORMED—Continued

1980	1981	1982
Special machinery	Savings & Loan	Paper and forest products
Steel	Steel	Real estate and housing
Textiles and apparel	Textiles, apparel	Savings & Loan
	Tire and rubber	Special machinery
		Steel
		Tire and rubber

Sources: Business Week, Mar. 16, 1981, pp. 81–116. Business Week, Mar. 15, 1982, pp. 69–104. Business Week, Mar. 14, 1983, pp. 61–98.

TABLE 2.—*Valuation ratios, 1980*

CSX Corporation	2.52
Chicago & Northwestern	0.77
Denver & Rio Grande Western	.90
Florida East Coast	1.29
Kansas City Southern	1.21
Norfolk & Western	.98
Soo Line	.94
Southern	.97
Simple average	1.20
AT&T	.78
Moody's Twenty-Four Electric Utilities	.66
Standard & Poor's 400 Industrials	1.32

Sources: Theodore E. Keeler, "Railroads, Freight, and Public Policy" (Washington, D.C.: The Brookings Institution, 1983), Table 1-5. Alfred E. Kahn, "Utility Regulation Revisited," in Albert L. Danielson and David R. Kamerschen, "Current Issues in Public-Utility Economics" (Lexington, Mass.: Lexington Books, 1983), Table 6-2.

The market valuation (market price to equity value) of the shares of these companies also does not suggest that these companies are in ill health (see Table 2). These stocks were not grossly undervalued in an absolute sense. In a relative sense they were somewhat below the national average, but accounting differences could again account for a large part of the difference. Other standard measures of economic health—financial ratios—used by the Commission until 1981, also do not present a picture of an industry that is totally revenue inadequate.

We might note that the group of 39 companies which were identified in testimony before the Commission as "comparable" to the railroads did just about the same, over the 1980–82 period, as the railroads did (see Table 3). The average rate of return for both groups was 11.7 percent. In the past two years railroads outperformed the comparison companies.

TABLE 3.—ANNUAL RETURN ON COMMON EQUITY

	1980	1981	1982	1980–82 Average
All-Industry Average	15.3	14.0	11.0	13.4
Railroad Average	13.9	12.5	8.7	11.7
Burlington Northern	10.4	10.2	6.1	8.9
CSX		12.1	10.4	11.3
Chicago & North Western Trans.	46.6	28.6	−12.1	21.0
Kansas City Southern Industries	19.5	17.8	13.4	16.9
Missouri Pacific	20.4	19.1		19.8
Norfolk & Western Railway	16.4	16.8		16.6
Norfolk Southern			11.9	11.9
Rio Grande Industries	11.3	10.8	6.1	9.4
Santa Fe Industries	15.3	9.9	7.3	10.8
Soo Line Railroad	17.0	16.1	6.7	13.3
Southern Pacific	7.5	7.5	5.4	6.8
Southern Railway	14.5	14.9		14.7
Union Pacific	15.4	13.6	10.1	13.0

TABLE 3.—ANNUAL RETURN ON COMMON EQUITY—Continued

	1980	1981	1982	1980–82 Average
Comparable companies	15.9	12.0	7.3	11.7
ACF Industries	12.5	12.1	9.0	11.2
Allied Chemical	19.1	16.5	10.5	15.4
American Brands	24.2	19.7	19.1	21.0
American Can Co.	8.4	5.9		7.7
Atlantic Richfield	25.3	20.1	17.5	21.0
Borden Inc.	12.3	12.4	12.6	12.4
Celanese Corp.	12.3	12.4	−3.4	7.1
Cities Service	20.5	11.9		16.2
Consolidated Foods	15.4	16.0	17.1	16.2
Dillingham Corp.	12.7	7.4	5.9	8.7
Eaton	13.0	8.1	−7.1	4.7
Englehard Minerals	43.8		16.2	30.0
Foremost-McKesson	15.7	15.8	12.8	14.8
Fruehauf	6.2	4.0	−6.3	1.3
GAF Corp.	−0.8	−23.6	6.0	−6.1
Goodrich (B.F.) Co.	6.6	8.9	−4.3	3.7
Goodyear Tire and Rubber	9.4	10.2	10.3	10.0
Grace (W.R.) Co.	17.4	18.0	14.7	16.7
Inland Steel	2.2	4.3	−11.1	−1.5
Insilco	16.8	14.8	10.9	14.2
Jewel CS Inc.	16.9	21.3	18.2	18.8
Johns Manville	6.2	3.9	−14.1	−1.3
Mesa Petroleum	22.5	18.7	17.1	19.4
Murphy (G.C.) Co.	7.9	8.0	3.4	6.4
National Steel	5.9	5.8	−36.0	−8.1
Ogden	14.7	14.6	11.0	13.4
Overseas Shipholding	21.0	18.1	11.1	16.7
Owens-Illinois Inc.	12.0	10.8	2.8	8.5
Pennwalt Corp.	10.8	8.1	5.5	8.1
Philip Morris Inc.	22.2	21.1	22.0	21.8
Reichhold Chemical	8.0	8.0	1.0	5.7
Reynolds (R.J.) Ind.	20.3	19.3	19.2	19.6
Reynolds Metals Co.	16.4	6.5	−1.9	7.0
Ryder Systems Inc.	17.8	15.6	15.5	16.3
Standard Oil of Ohio	71.9	34.6	27.2	44.6
Southland	15.1	15.7	15.8	15.5
United Technologies	18.3	15.5	13.1	15.6
Wickes	.7	4.5	N.M.	2.6
Williams Co.	17.6	9.6	2.9	10.0

Sources: Business Week, March 16, 1981, pp. 81–116, March 15, 1982, pp. 69–104, March 14, 1983, pp. 61–98.

Note: The railroad figures are not adjusted for betterment accounting or returns on deferred taxes which are unique to the industry and tend to lower the rate of return.

If one assumes a random distribution of risk preferences and a random distribution of risk opportunities that are directly related to returns, then it is clear that an industry that constantly falls within one standard deviation of the mean of the national average will have no difficulty funding investors. The industry would be a more attractive investment opportunity than one-sixth of the economy and would have little difficulty attracting investors.

Not surprisingly, by the Commission's methodology, a sizable chunk of the economy—almost one-half—would be deemed revenue inadequate. Thus, the test devised by the Commission has vastly overstated revenue needs and, therefore, ensures that monopoly profits will be extracted.

The weaknesses in the Commission's approach to measuring revenue needs points to and links up with the weaknesses in its approach to moving the industry onto a more stable economic footing. Every decision it has made reflects a preoccupation with ratemaking and the extraction of monopoly profits as the basic approach to meeting revenue adequacy. The empirical evidence suggests overwhelmingly that it is exactly the other areas of rail operation, including rates on competitive commodities, that hold the key to efficient operation and economic viability.

In addition, the Commission is unwilling to distinguish between sunk costs, which are supportable by demand but not by the cost structure of railroads, and sunk costs that are not supported by sufficiency of demand. If demand is not adequate—i.e., volume is low—then at some point costs should not be recouped and investors should not be attracted.

To the detriment of captive shippers and consumers, the Commission has taken an approach to meeting the legitimate needs of the railroads that lays the weakest basis for establishing the long term economic viability of the railroads. Instead of encouraging and calculating efficiency improvements as the solution, the Commission is relying on ratemaking to fill revenue needs. In disregard of overwhelming empirical evidence which shows that, by efficiency criteria, coal ratemaking should provide a very small fraction of the solution to the railroads' revenue problem—on the order of 10 to 15 percent—the Commission is trying to make coal shippers, and ultimately utility comsumers, bear the vast majority of the burden of the solution. Given its methodology for estimating revenue needs and coasts, coal could bear 90 percent of the burden.

Even more troubling is the fact that the approach based on coal rate increases will help those railroads most that need it least. Railroads that haul significant quantities of coal generally have been the most economically viable. They do not need exorbitant rate increases to establish or maintain their economic health, but the Commission would give them such increases.

Even if revenue needs were properly calculated, the methodology for setting coal rate ceilings chosen by the Commission would be unacceptable. The Commission's willingness to countenance massive increases in coal rates apparently stems from a facile theory of ratesetting that is plagued by unrealistic assumptions and informational problems that are monumental.

PROBLEMS WITH THE COMMISSION'S APPROACH TO RATEMAKING

Given the general principle that regulators must aim for pricing rules that approximate first best solutions, it is clear that, in terms of strict efficiency criteria, marginal cost pricing, or the closest approximation to it, is the goal. Where marginal cost pricing is not possible, a second best solution—differential pricing—is sought. One such solution proposed by the railroads is Ramsey pricing. However, the strongest economic basis for this second best rule is a situation in which marginal costs are below average costs. Under these circumstances marginal cost pricing leads to chronic deficits. Absent a lump sum subsidy, an effort to raise revenues above marginal costs must be made by differential pricing.

The infirmities from which Ramsey pricing suffers, however, are legion (see Table 4). To begin with, rather strong evidence exists that marginal costs in the railroad industry do not fall below average costs—i.e., returns to scale for railroads at their current levels are constant or decreasing in some cases and increasing only slightly in others. At efficient and easily achievable levels of operation, there would be very few economies of scale. Therefore, the basic justification for deviations from marginal cost pricing is absent.

In the absence of significant long run economies of scale, a case for differential pricing can be made on the basis of the unallocability of costs. If one must guess how to price the products of a multiproduct firm, one may overprice the products to some customers and lose their business. This creates a deficit and need for increasing prices to other customers. Under the same set of restrictive assumptions, Ramsey pricing becomes attractive when all costs cannot be traced directly to services provided and when there are significant differences in the sensitivity of demand to price because it minimizes the danger of losing business. In the long run, of course, there may be no unallocable costs, but the need to set rates in the short run does dictate a search for second best rate setting rules.

TABLE 4.—THEORETICAL AND PRACTICAL DIFFICULTIES OF RAMSEY PRICING/STAND-ALONE-COST-IN-ISOLATION-WITHOUT-SEGMENTATION

Ramsey pricing	Stand-alone-cost-in-isolation-without-segmentation
Economic assumptions:	
Beneficient tax setter and monopolist do not have same motivations.	Rational actors would not be bound by irrational assumptions.
Absence of long-run economies of scale	Absence of long-run economies of scale.
Demand curve is distorted	Monopoly profits cannot be excluded.

TABLE 4.—THEORETICAL AND PRACTICAL DIFFICULTIES OF RAMSEY PRICING/STAND-ALONE-COST-IN-ISOLATION-WITHOUT-SEGMENTATION—Continued

Ramsey pricing	Stand-alone-cost-in-isolation-without-segmentation
Closely related markets are not perfect	Closely related markets are not perfect.
Uniform price schedule is not optimal	
Demand may not be independent	Demand may not be independent.
Secondary macroeconomic costs are high	Secondary macroeconomic costs are high.
Equity criteria:	
Equality is arbitrary and not indicated by policy	Minimalist definition is unacceptable to rational actors.
Practical difficulties:	
Partially regulated markets shift costs to regulated sector	Partially regulated markets shift costs to regulated sector.
Information problems are insurmountable	Information problems are insurmountable.

The Ramsey second best solution still fails. Under all circumstances, the economic assumptions that are required for the Ramsey pricing rule to be appropriate are very unlikely to hold in reality. Ramsey pricing requires critical assumptions about the competitiveness of other markets, the impact of price changes, etc., to be an efficient second best rule. These assumptions are highly suspect. Because of its inapplicable assumptions, the claim of the Ramsey pricing rule to superior efficiency outcomes is thrown into doubt. Of equal importance is the fact that the equity principle underlying the Ramsey pricing approach cannot accord with the intent of the Staggers Act. The Ramsey equity principle (which is arbitrary) treats all consumer and producer surplus as equally weighted and therefore is totally indifferent to the distribution of surplus. Efficiency and equity are thus equated. The largest surplus is the best, no matter how it is distributed. But, the Staggers Act explicitly sets up an equity test—reasonableness—in addition to an efficiency test.

The truth is that the interdependencies of demand, difficulties of estimating elasticities, imperfections in other markets, data requirements, etc., are so extensive and complex that the entire approach is unworkable. The Ramsey pricing rule is almost always doomed in advance to error and misrepresentation, leading to inefficiency and inequity. In fact, it has not been applied in any regulatory framework that we know of.

Railroads and the Commission offer stand alone cost with costs estimated in isolation and no segmentation of facilities as the third best solution. We are presented with the ironic situation that the greater the difficulty in allocating costs in the first place, the greater will be the difficulty of stand-alone-cost-in-isolation-without-segmentation in the third place. The weakness occurs exactly in those cases about which the Staggers Act expresses most concern, where shippers account for a relatively small portion of the overall revenues or where there are low densities and therefore the likelihood of inefficiency is greatest. Although it can claim some economic rationale, stand alone costing is only one among many third best solutions and it has peculiar attributes which are contrary to the explicit intent of the Staggers Act. Stand alone costing ratifies the inefficient monopoly price and camouflages cross subsidization. Therefore, stand alone costing has as its basis the weakest possible efficiency rule and the weakest possible equity principle.

We are not suggesting by any means that the Commission give up the pursuit of efficiency because of the difficulties of implementing any particular pricing rule. Rather, we are suggesting that it should assess rules according to their likely impact in practice, not their theoretical purity.

It is entirely possible that a third best approach which is easily and truthfully implementable will lead, in reality, to a better efficiency outcome than a second best rule which is extremely difficult to implement and of necessity leads to highly imperfect outcomes that deviate widely from the second best ideal. The Commission should not make a comparison between the second best ideal and other, third best alternatives. Rather, it should compare the second best alternative rendered third best (because of deviations of assumptions from reality, information problems, etc.) and the other third best alternatives with their blemishes.

Ramsey pricing and stand-alone-cost-in-isolation-without-segmentation start from the inelastic portion of the demand curve, encouraging high rates for shippers with inelastic demand while asserting that profit maximizing behavior will not lead to the extraction of monopoly profits and will lead to efficiency maximizing rates on competitive traffic. Other approaches start from the elastic side of the demand curve, insisting that the railroads maximize the contributions from those shippers in competitive markets, thereby holding rates down for captive shippers who are most vulnerable to exploitation.

The Ramsey pricing/stand-alone-cost-in-isolation-without-segmentation approach sets prices based on an estimate of costs based on the least efficient alternative—i.e., the alternative without any of the efficiencies of an integrated rail operation. In general, the other approaches set prices based on an estimate of the cost of the most efficient alternative—the rail network without any of the inefficiencies of the existing rail operation—or with at least some efficiencies of organization taken into account (by grouping shippers and taking other traffic into account).

The Ramsey pricing/stand-alone-cost approach asserts that cross subsidization is precluded if pure cross subsidization is avoided. If shippers contribute only to facilities from which they gain "some" benefits, no matter how extremely remote the benefits are, that is considered to prevent cross subsidization, no matter how much the contribution outweighs the benefit. The alternative approaches seek to equalize contributions by matching the costs caused by each shipper to the benefits enjoyed by that shipper.

The Ramsey pricing/stand-alone-cost-in-isolation-without-segmentation approach might move railroads to revenue adequacy more quickly, but it will not do so more efficiently, and it will do so less equitably. The alternatives will enable the railroads to achieve revenue adequacy while doing much less damage to equity and ensuring an efficient approach.

In our testimony on ex parte 347, CECA demonstrates that there are a number of alternatives which yield roughly similar tests of reasonableness as measured by ceilings of revenue to variable cost ratios. This reasonable range is 180–190 percent of variable costs in the critical test cases (those where coal is a modest percentage of total freight). These are in diametric contrast to the Ramsey pricing/stand-alone-cost-in-isolation-without-segmentation approach, which yields revenue to variable cost ratios of 250–500 percent in similar cases.

The lower revenues to variable cost ceilings would hold the most vulnerable shippers to costs that are about one-third higher than the system average would be at revenue adequacy, which represents a very stiff dose of differential pricing in an industry that may have little hard economic justification (i.e., economies of scale) for any differential pricing whatsoever. It would not delay revenue adequacy for a significant period, except that it would force railroads to achieve adequacy the right and hard way, by pulling up revenues at the bottom through efficiency rather than by pumping them up at the top through extraction of monopoly profits.

The fact that a variety of pricing rules lead to similar results, invoking different rationales and promising slightly different trajectories to revenue adequacy, while achieving greater equity, should not be of concern. Third best rules do, in fact, tend to be indeterminant. However, the range of indeterminancy and the trading of small losses in efficiency at the margin for such clear cut and socially desirable gains in equity is much more attractive than lofty second best ideals that degenerate into unascertainable indeterminancy and exploitation. Indeed, if anything, the rather narrow range of estimated revenue to variable cost ceilings should be encouraging. It shows that whenever serious efforts are made to achieve a balance between the competing goals of the Act in exactly those cases where the balancing act is most difficult, the outcome is roughly the same.

In our testimony on ex parte 347, we elaborate on a ratemaking approach based on the following principles:

1. Increases in ceiling rates on coal must follow, not precede, efficiency gains.
2. Increases in coal rate ceilings should be in proportion to efficiency gains.
3. Access to a faster track for the few railroads that might actually face cost-structural obstacles to economic viability must be limited, but can be allowed. The fast track would allow increases less than twice the size of the national average after several years in which efficiency gains were made.
4. Use of fast track must be balanced by periods in which attention is directed to efficiency improvements.

This approach comports much more closely with the Staggers Act and a number of prior court decisions. It takes a complete view of what the marketplace is and how it operates. It uses economic justifications for contributions to revenue adequacy based on analysis of the structure of the industry. It provides real incentives to efficient management. While assisting railroads to meet revenue adequacy, it keeps the burden on captive shippers to reasonable levels. Such an approach highlights the one-sided view that the Commission has taken in this and related proceedings. While our approach could surely be improved upon, it shows that the competing goals of the Staggers Act can be balanced in an equitable manner.

CONCLUSION

The fundamental need for greater restraint in coal ratemaking stems from the basic fact that coal is shipped under monopoly conditions. Railroads will try to maximize their profits not by increasing efficiency but by raising rates on captive lines. The Commission's methodology for providing railroads with adequate revenue ignores the legitimate equity concerns of shippers and consumers and ultimately distorts the nation's energy goals. Contrary to the directives of the Staggers Rail Act, the Commission has adopted an approach that blatantly overcompensates the railroads. The capricious 15 percent solution that the Commission has chosen to insure the railroads' revenue adequacy turns the carefully constructed Staggers Act on its head. Unrestrained, the railroads will be able to accrue unjustifiable revenues. CECA urges Congress to ensure that the Commission balance its ratemaking criteria and open its eyes to the disasterous effects that their current proposal will bring.

If the current errors are not corrected, the following results are likely to occur:

1. Captive coal shippers could end up bearing 90 percent of the revenue adequacy burden.
2. There will be a 200 percent increase in coal rates over a 10 year period, assuming a 12 percent annual increase (above inflation).
3. The nations' electricity bill over the same 10 year period could rise by up to $7.2 billion.
4. The mid-West, South and Mountain States and particularly low and lower middle income groups will face the prospect of prohibitively high electricity rates.

I appreciate the opportunity to submit this statement before the Subcommittee and would be happy to work with you in devising an equitable policy.

STATEMENT OF JAMES W. LAWSON, ATTORNEY, ON BEHALF OF NEVADA POWER CO. AND INDIANAPOLIS POWER & LIGHT CO.

I. Introduction

I am an attorney admitted to practice in the District of Columbia, Maryland and Missouri. My remarks are based upon day-to-day experience in rail rate and rulemaking proceedings before the Interstate Commerce Commission and in court appeals.

This statement is submitted on behalf of Nevada Power Company and Indianapolis Power & Light Company.

Nevada Power Company operates a coal-fired generating station at Moapa, Nevada. This plant receives 1,000,000 tons of coal per year delivered by the Union Pacific Railroad Company, originated by the Utah Railway Company at Hiawatha, Utah and the Denver and Rio Grande Western Railroad Company at Acco, Utah. Commencing in 1983, Nevada Power will receive an additional 1,000,000 tons per year of coal due to an increase in plant capacity.

Indianapolis Power & Light Company currently operates five coal-fired stations in Indiana, four of which receive approximately 4.5 million tons of coal per year by rail. This coal moves in intrastate commerce via ConRail, Illinois Central Gulf, Algers Winslow & Western, and Milwaukee Road railroads. In total, IPL burns over five million tons of coal annually and it is expected that this total will almost double as its capacity increases over the next ten years.

The actions of the Interstate Commerce Commission under the guise of implementing the Staggers Act has adversely affected utilities such as Nevada Power Company and Indianapolis Power and Light Company which ship coal by rail and has hurt the customers of those utilities. Concomitantly, the Commission's decisions have hurt coal producers in the United States by reducing their domestic and export markets.

This statement (1) details the changes to the Staggers Act which are necessary if the Act's stated purposes are to be fulfilled; (2) provides a brief description of the Interstate Commerce Commission's actions since the 4-R Act which have affected railroad rates for coal; and (3) describes some of the Commission's ongoing proceedings that are biased in the railroads favor. Additionally, Appendix A presents an in-depth discussion of changes needed in selected sections of the Staggers Act and Appendix B provides the candid views of the I.C.C. Office of General Counsel on the Commission's proposed decision in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines-Nationwide.

II. Summary of conclusions and recommendations

When the Staggers Rail Act of 1980 was passed, it was hailed by the Carter Administration as completing its goal of deregulating transportation by air, truck and rail.

However, the Staggers Act does not really deregulate. It merely allows the carriers to increase substantially their prices on captive traffic and to lower substantially their prices on competitive traffic. The Staggers Act, is implemented by the I.C.C., has complicated, confused and paralyzed the regulatory process.

The complexities of the statute have been exacerbated by a Commission which never paused long enough to appraise the intent of the Staggers Act, and which ignored and distorted the plain meaning of numerous provisions of the statute so as to plunge onward in its course of de facto abandonment of pricing restraints on captive and competitive traffic. The rulemaking activities of the Commission in implementation of the Staggers Act, characterized by bias and predisposition in favor of the railroads displayed in the notices of proposed rulemaking, were carefully orchestrated by the Association of American Railroads through the I.C.C.'s Office of Policy and Analysis, headed by a former official of the A.A.R. Although the O.P.A. has been disbanded since setting the framework by proposing heavily pro-railroad rules, which have been largely adopted, its function of supplying the rationale for higher rail rates is now performed in the same one-sided manner by the Bureau of Accounts.

The I.C.C.'s ratemaking and rulemaking processes have been left in shambles as a result of rationalizing goals rather than applying facts, laws, sound economic principles.

Congress and the I.C.C. must both recognize the need for continued protection of the public interest against the potential abuses of rail monopoly power. Both must also recognize that just administration of this complex statue will require increased resources, rather than short-cut solutions.

Since the passage of the Staggers Act, the bias and predisposition in favor of the railroads displayed in the various notices of proposed rulemaking has been confirmed in every rulemaking decision; the I.C.C. has been paralyzed, unable to decide any major coal rate case in nearly 3 years, most of the previously decide cases have been waiting for periods of 1½–2 years of more for futher proceedings, after court remand with the railroads continuing to collect and the electric customers continuing to pay the challenged rates. In the case of Nevada Power, its Hiawatha rate filed in 1978 and its Acco rate filed in 1980 are still unresolved. The railroads continue to charge excessive rates as the I.C.C. dawdles with one ridiculous rulemaking proposal after the next while failing to rates through ratemaking cases. Conventionally, regulated entitled are allowed to charge only rates which are consistent with rate theory at the time of implementation. Here, an I.C.C. encapsulated by the railroads, fails to apply existing rate theory to present rates and instead ignores this duty and dwells upon invention of new theory to justify a higher level of rates. Even the efforts at rulemaking incredibly fail to deal with the issues necessary to resolve pending cases in which rate levels are far too high. For example, the Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines decision deals only with justifying increases in rates without addressing the fundamental problem of adjudicating rates now in litigation through setting the base rates themselves. Stripping away profound pronouncements (or is it "mumbo-jumbo" as the I.C.C.'s general counsel says), the Coal Rate Guidelines is an empty-headed exercise in bureaucratic nonsense.

The Stagger Act is flawed. A significant number of changes are needed in the Act to produce the sound and economically efficient transportation network Congress sought in passing the Act. The major changes which are needed follow with asterisks indicating those sections of the Act which are more fulled covered in Appendix A of this submission:

Section	Changes to be made
201*	Redefine minimum rate standards so that competitive traffic pays for itself and does not not require cross-subsidization by captive coal traffic.
202*	(a) Redefine cost recovery percentage so as to exciude traffic handled at or below variable cost. (b) Change the jurisdicational threshold provisions so that the percentages which now constitute the rate floor will become the rate maximum with respect to captive coal traffic being utilized for electric power generation. (c) Enact the I.C.C.'s former rebuttable presumptions of market dominance, namely: 1. market share, 2. ratio of rate-to-cost, and 3. substantial shipper investment.

Section	Changes to be made
	(d) Redefine variable cost in meaningful terms. At present, the Commission utilizes different definitions of variable costs for different purposes (minimum rates versus maximum rates).
203*	Specify that the Long-Cannon Amendment is to be considered in all rate reasonableness cases in that the carriers must present evidence in detail with respect to each of the three criteria or, failing to do so, their rates will automatically be set at the jurisdictional threshold (or fully allocated cost on the dollar ratio basis, at the revenue need level if rate cap is enacted) in Section 202.
205*	(a) Forbid consideration of product and/or geographic competition on any issues, whether market dominance, rate reasonableness, or otherwise, in cases involving shipment of coal.
	(b) Set forth revenue adequacy standards which require consideration of all 7 financial ratios, in the manner formerly done by the Commission prior to its decision in Ex Parte No. 393.
	(c) Require that the Commission (1) exclude deferred taxes from the rate base, (2) utilize embedded, rather than current, cost of debt, and (3) utilize depreciation, rather than betterment accounting in calculating its ratios.
206*	Require that the I.C.C. make productivity adjustments in calculating allowable inflation-based rate increases, and require that carriers decrease rates, in times of decreasing cost, to the extent those rates have been adjusted upward through inflation-based rate increases under this section.
207	Provide that the time limitations for Commission action and rate investigations shall apply to cases being considered on remand and that the time limitations for reconsideration of Commission actions under 49 U.S.C. § 103027(g)(2) shall also apply to Section 103027(g)(1).
208	Require that rail rate contracts be made available, for examination, in their entirety upon request.
213*	Provide that the I.C.C.'s general exemption authority shall not be utilized to (1) circumvent the provision of the long and short haul and aggregate of intermediate clauses, or (2) exempt export or any other coal traffic from maximum rate regulation.
214*	Provide that shippers, as well as carriers, shall have the right to seek review before I.C.C. of adverse determinations by state authorities on intrastate rate matters. Section 214 unnecessarily usurps state authority to govern intrastate rail rates by requiring state commissions to exercise jurisdiction over intrastate transportation exclusively in accordance with standards and procedures of the Interstate Commerce Commission. This section should be revised to allow responsible state control in keeping with the rail transportation policy under § 10101a.
216*	Provide that any rate describing a type of service not previously provided will be considered a new rate, which must be published on 20 days notice, rather than a rate decrease, which is entitled to only 10 days advance notice.
217	Redefine variable costs in meaningful terms.
221	Provide for consideration of unilaterial trackage applications. Require carriers to afford each other cost-justified reciprocal trackage agreements and submit competitive rate bids where requested to do so by captive shippers.
229*	Abolish in its entirety.
302	Require implementation of provisions with respect to rail road cost accounting which have been ignored, including those concerning Railroad Accounting Principles Board, cost accounting principles, implementation of cost accounting principles, certification of rail carrier cost accounting systems, cost availability, accounting and cost reporting, and the report of the Railroad Accounting Principles Board to Congress with recommendations for appropriate legislative or administrative action.

III. Background on the implementation of the Staggers Act

An understanding of the interrelationships among various proceedings is needed to fully comprehend the way the I.C.C. has implemented the Staggers Act and what the alternatives to the Commission's decisions were.

During the 1970's, Congress determined that the regulation of the nation's railroads was not providing the proper economic balance and enacted serveral statutes. In 1976 Congress enacted the Railroad Revitalization and Regulatory Reform Act of 1976 ("4-R Act") Public Law 94-210.[1] This statute established various financial criteria that the I.C.C. should consider in determining whether a railroad was revenue adequate. The Commission promulgated standards under the 4-R Act[2] which provided for consideration of all pertinent financial indicators in determining whether a rail carrier was revenue adequate. In applying these standards, the Commission determined that 13 of the 36 Class I railroads then operating in the United States were revenue adequate.[3]

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[1] 49 U.S.C. § 10704(a)(2). This amends the Interstate Commerce Act.

[2] 49 C.F.R. § 1109.25 (1978).

[3] 362. I.C.C. 198 (1979) ("Ex Parte No. 353").

In 1980, Congress enacted the Staggers Rail Act of 1980 (Staggers Act) Public Law 96–448. The Act substantially amends the Interstate Commerce Act, but it continued the definition of revenue adequacy enacted in the 4–R Act. Congress in the Staggers Act used revenue adequacy as the basis for determining when railroads should be allowed certain new rate freedoms. Congress also required the Commission to make yearly determinations as to which railroads were revenue adequate and to maintain and revise, as necessary, regulations with respect to determination of revenue adequacy.[4]

The Commission instituted Ex Parte No. 393, Standards for Railroad Revenue Adequacy [5] in response to the Staggers Act. The Commission, after public comment, held that it would no longer consider all available financial evidence in the revenue adequacy determination of individual railroads. This reversed its decision in Ex Parte Nos. 338 and 353. The Commission decided to base its revenue adequacy deteminations solely on the rate of return a railroad is earning on its net investment base. Revenue adequacy would be found if the railroad was earning a return equal to the current cost of capital for the railroad industry, as determined by the I.C.C. Whereas 13 railroads were deemed revenue adequate under the old rules, this change in the rules of the game resulted in an initial determination that only 3 (later 2, and now none) of the 31 railroads were revenue adequate, thus entitling all of the rest to whatever benefits, there unspecified, might be otherwise determined to flow from that designation.

At the same time the Commission was considering the subject of railroad revenue adequacy, it was considering the appropriate rates that railroads could charge for transporting coal. Originally the Commission instituted Ex Parte No. 347, Western Coal Investigation-Guidelines for Railroad Rate Structure. This inquiry was broadened to a nationwide scope in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines-Nationwide. In Ex Parte No. 347 (Sub-No. 1) the Commission has recently proposed allowing railroads to increase the rates they charge for shipping domestic coal by 15 percent per year plus inflation, up to a maximum of what it would cost the shippers to construct the railroad itself. A current environmental and energy impact inquiry stems from the Commission's finding that implementation of rail increases of such a magnitude may significantly affect the environment and energy posture of the United States.

The way the Commission has addressed each of these two areas, revenue adequacy and coal rates, is detailed below. Many facts that the Commission ignores, but that Congress must recognize, are detailed in the succeeding pages. Additionally, other related proceedings are briefly described.

It must be noted that the Principal flaw of the Staggers Act is the use of jurisdictional thresholds which guarantee that the railroads will be able to charge rates far above the cost of service. It has been calculated in connection with rate litigation by Nevada Power Company that the Union Pacific Railroad Company has a return at various revenue/cost ratios based upon 1980 expense and investment, less accumulated deferred income taxes as follows:

[In percent]

Ratio of rate to variable cost	Union Pacific Railroad pretax return on equity
141.60	25.00
160.00	44.43
170.00	55.00
180.00	65.56

Electric utilities should not be required to subsidize the railroad industry by providing pre-tax returns on equity of 55 to 65 percent through jurisdictional threshold rates ranging from 170 to 180 percent.

These thresholds represent an unconscionable taxing of coal producers and consumers for the benefit of the railroads and their other customers. This transfer of wealth from coal producers and consumers, principally the electric utility industry, is in direct conflict with the national energy goals professed by Congress elsewhere and referenced in the Staggers Act. If the I.C.C. had done an environmental and energy assessment of the effects of the jurisdictional thresholds at the time the legislation was proposed, as required by statute, it would never have been enacted.

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[4] 49 U.S.C. § 10704(a)(4).

[5] 45 Federal Register 80, 150 (Dec. 3, 1980).

IV. Major ongoing proceedings before the I.C.C. that affect only coal shippers

A. REVENUE ADEQUACY

In a separate proceeding the Commission has sought to determine the level of revenues which railroads require to become revenue adequate. Looking exclusively at proper rates for coal transportation or revenue adequacy produces distortions of fact and has led to improper decisions by the Commission. The Commission has been attempting to solve a complex problem in a simplistic, piecemeal way. The result does not conform to the reasonable and efficient standards required by 49 U.S.C. § 10704(a)(2):

"The Commission shall maintain and revise as necessary standards and procedures for establishing revenue levels for rail carriers . . . that are adequate, under honest, economical, and efficient management, to cover total operating expenses, including depreciation and obsolescence, plus a reasonable and economic profit or return (or both) on capital employed in the business. . . . Revenue levels . . . should—

"(A) provide a flow of net income plus depreciation adequate to support prudent capital outlays, assure the repayment of a reasonable level of debt, permit the raising of needed equity capital, and cover the effects of inflation; and

"(B) attract and retain capital in amounts adequate to provide a sound transportation system in the United States."

Both the 4R Act and the Staggers Act provide guidance in the determination of what is "reasonable." The 4R Act states: "It is declared to be the policy of the Congress in this Act to—(1) balance the needs of carriers, shippers, and the public; . . ." 45 U.S.C. § 801(b); Public Law 94-210 § 101. The Staggers Act states: "[T]he goals of this Act are—. . . to provide a regulatory process that balances the needs of carriers, shippers, and the public; . . . ." Section 3(4); 49 U.S.C. § 10101a note. Thus, reasonable rates must be "balanced;" they must not tilt toward one side or the other. This section considers the history of the revenue adequacy determination and the need for realistic standards when revenue adequacy is joined with guidelines for coal rates.

1. Legislative history

The legislative history of the statutory requirement for revenue adequacy standards is clear. The Senate report states: "In considering adequate revenue levels, the Commission will be expected to utilize the most modern financial techniques available . . ." S. Rep. No. 94-499: Report to the Senate Committee on S. 2718, Rail Services Act of 1975, November 26, 1975, pp. 51-52. House Report No. 94-725, 94th Cong. 1st Sess. 73 (1975) states: "[T]he Commission shall take into consideration productivity factors and financially sound debt and equity ratios."

2. Rulemaking history

a. Ex parte No. 338

The Commission promulgated regulations to implement those statutory requirements at 49 C.F.R. 1109.25:

(a) Standards

(1) The revenue adequacy of the Nation's railroads on a composite level shall be judged in accordance with the criteria of section 15a(4) and upon consideration of all pertinent financial indicators, including a rate of return on net investment equal to the cost of capital, other financial ratios, and the flow of funds.

(2) The revenue adequacy of an individual carrier shall be determined in accordance with the criteria of section 15a(4), upon consideration of all pertinent financial indicators and other evidence as to ability to make needed investment.

(3) The need for revenue adequacy will be taken into account and regarded as a highly important factor both in general rate increase proceedings and in individual rate proceedings.

b. Ex parte No. 353

The Commission applied the standards required under Ex Parte No. 338 and concluded:

Data for 36 Class I railroads was submitted. We have concluded that 13 have adequate revenue and that the other 23 do not.

Ex Parte No. 353 at 256.—**The Commission's findings in Ex Parte No. 353 were consistent with those in the National Energy Transportation Study, A Preliminary Report to the President by the Secretary of Transportation and the Secretary of Energy, July 1980, which recognizes the need for adequate railroad revenues and sets forth at page 66:**

TABLE 4–2.—FINANCIAL RANKINGS AND BOND RATINGS OF PRIMARY COAL-HAULING RAILROAD COMPANIES

	Categories [1]	Railroads (Standard and Poor's Rating)
Group I	Companies currently performing well above the minimum expectations of the capital markets and, in their present condition, should have little trouble raising private capital.	Union Pacific (AAA).[2] Norfolk & Western (AA). Santa Fe (AA).[2] Southern (A+). Denver & Rio Grande Western (A).[2] Southern Pacific (A).[1],[2]
Group II	Companies currently performing on a par with what us considered "adequate." These companies can probably raise money in the capital market at all times. When money is tight, however, they would probably have to pay significantly higher rates..	Family Lines (Seaboard Coast Lines (A), Louisville & Nashville (BBB). Clinchfield, Georgia) Chessie System (Chesapeake & Ohio (AA), Baltimore & Ohio (BB), Western Maryland). Burlington Northern (A).[2] Missouri Pacific (A–).[2]
Group III	Companies that are bankrupt or having a difficult time making a profit. These companies find credit expensive at all times and some may find it unavailable when money is tight.	St. Louis—San Francisco (BBB). Chicago & North Western (B). Chicago, Milwaukee, St. Paul & Pacific (D).[2] Illinois Central Gulf (BBB).[2] Conrail.

[1] The ranking of railroad companies was based on a combination of several measures of financial strength in addition to the one listed here. For details, see source below.

[2] Railroads and railroad holding companies that receive more than 10 percent of their revenues from nonrail sources. They are listed whether or not the parent company is technically classified as a holding company. For example, the Burlington Northern, which is listed, is not a holding company although 15 percent of revenues come from nonrail sources. Seaboard Coast Line industries, on the other hand, is a holding company but only about 4 percent of revenues come form nonrailroad operations.

[3] The Southern Pacific railroad is expected to become a major coal carrier in the near future. It has, therefore, been included in the analysis.

Source: Imput Ouput Computer Services, Inc., Financial Analysis of Coal Transportation by Rail (Washington, D.C. U.S. Department of Transportation, 1979).

The NETS Study rated four coal carrying railroads as adequate, six well above, and only five below. Among those which the Commission had rated not revenue adequate in Ex Parte No. 353, were carriers which NETS rated as adequate, namely, the L&N, and B&O, the Burlington Northern and, well above adequate, namely the Santa Fe, and the Southern Pacific. The Commission's decision in Ex Parte No. 353 *Section of Financial Analysis,* Warren L. Ginn, based upon a survey of the views of a large number of investment security analysts, *recommended* use of seven financial ratios and measures, including *operating ratio, net cash flow, fixed charge coverage, throw-off to debt, dividend payout ratio, return on equity,* and *return on total capital.* The Committee should note that Mr. Ginn concluded: "Using these tests, our evaluations reveal that four carriers have adequate revenues based on ROI equal to cost of capital. These carriers are the Bessemer & Lake Erie; Elgin, Joliet & Eastern, Clinchfield; and the Fort Worth & Denver. Four additional carriers have ROI's below the cost of capital rate but have ROE, ROTC, TOTD, FCC, and operating ratios that are better than the respective standards. These carriers are the Norfolk & Western; Florida East Coast; Southern; and the Soo Line. Finally, four more carriers have ROI, ROE, and ROTC somewhat below standard but have an overall financial position suggesting revenue adequacy. These carriers are the Denver & Rio Grande Western; Missouri Pacific; St. Louis-Southwestern; and the Union Pacific. The remaining 23 carriers have inadequate revenues at the present time."

Those criteria are eminently sound and are supported by an I.C.C. telephone survey of analysts.[6]

The I.C.C. subsequently relied upon growth forecasts by analysts in determining the current cost of capital.[7]

On the one hand, the I.C.C. ignores a staff survey of analysts when they support Mr. Ginn's revenue adequacy standards, which it also ignores, and which would render 12 railroads revenue adequate. On the other hand, the I.C.C. endorses growth forecasts by seven analysts (of whom three were named in the ignored staff survey) when those forecasts favor the railroads. Quite apparently the I.C.C. picks and chooses that which favors the railroads and rejects that which does not. It is time that this favoritism and prejudice be replaced by impartial regulation in the public interest.

During the course of the Senate Legislative Oversight Hearings on July 26, 1983, I.C.C. Bureau of Accounts Director Ronald S. Young attempted to absolve the present members of the Commission, pointing out that the staff recommendation and decision thereon ante-dated their tenure. However, this excuse was as misleading as the rationale for the decision itself. For Nevada Power, after obtaining the Ginn memo, has subsequently incuded it in evidence filed in 3 separate proceedings decided by present members of the I.C.C.[8] Thus the memo has been formally and officially before the Commission as evidence in 3 cases which they have decided while ignoring the memo. This memo was included in its entirety in the Comments of the Edison Electric Institute in the present hearings.

3. Railroad income and taxes

In the past, many railroads were generally viewed as revenue inadequate. While the railroads assert they all continue to be revenue inadequate, most are not. Figure 1 depicts the level of income of railroads as a whole from 1971 to 1981 as currently reported by the Association of American Railroads. It can be seen that since the 4-R Act was enacted in 1976, railroad income has increased dramatically.

While railroad income is up, railroad taxes are down drastically. As deomonstrated in Figure 2 railroad taxes actually paid have fallen to the lowest level in the 10 years reported by the Association of American Railroads. The reason for this is the huge tax breaks accorded American industry in general and the railroad industry in particular in the past few years by Congress. These tax breaks have allowed the railroads to increase their net income substantially. Most of the taxes which the railroads would have paid but for the tax breaks have been deferred into the future, perhaps indefinitely. These deferred taxes are essentially an interest-free loan by other taxpayers.

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[6] First Boston, L. F. Rothschild, Merrill Lynch, Metropolitan Life, Printon Kane Research, Kidder Peabody, Morgan Guaranty, Alexander Brown, Moody's, Salomon Bros., Fahnestock & Co., and Morgan Stanley.

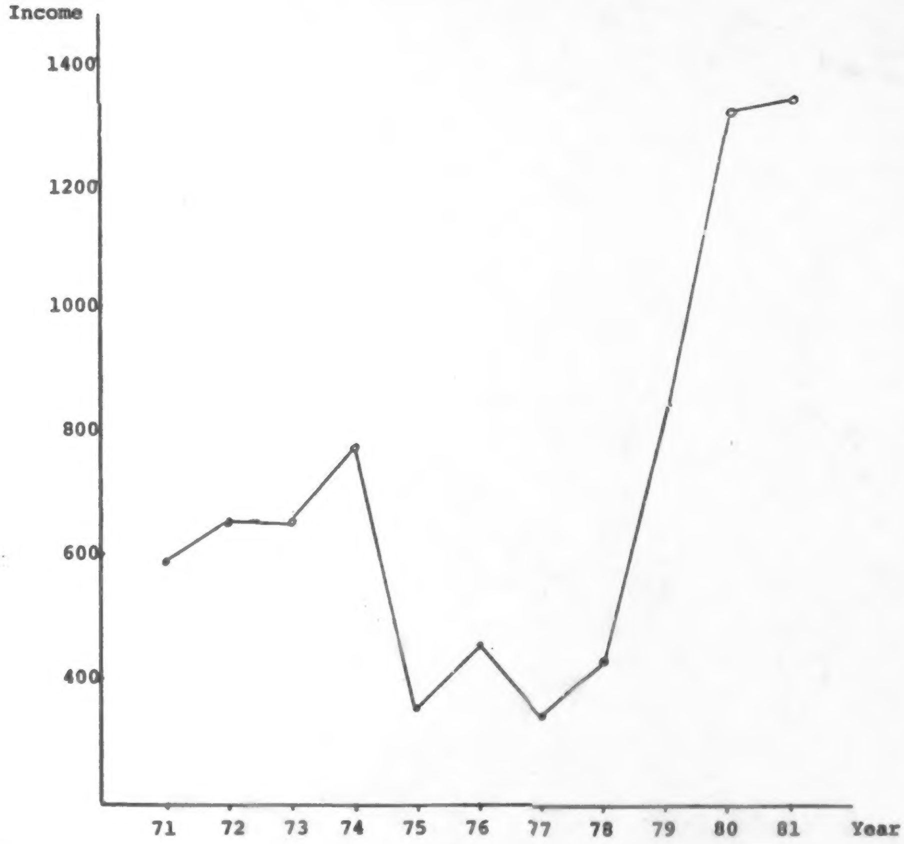
[7] Goldman Sachs; Merrill Lynch; Wells Fargo; Value Line; Morgan Stanley; E. F. Hutton; and Kidder Peabody in Ex Parte No. 415, *Railroad Cost of Capital—1981,* 365 I.C.C. 734, at 740, 742–43. In that proceeding, a representative of Salomon Brothers presented evidence for the railroads. 365 I.C.C. 734.

[8] (1) Comments May 11, 1981 in Ex Parte No. 347 (Sub-No. 1) Coal Rate Gudielines-Nationwide, decisions issued December 16, 1981 and February 24, 1983; (2) petition April 22, 1982 in Docket No. 38754, Arkansas Power & Light Company, et al., Petition to Institute Rulemaking Proceeding-Implementation of Long-Cannon Amendment to the Staggers Rail Act, Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines Nationwide, Ex Parte No. 393, Standards for Railroad Revenue Adequacy, decision issued September 3, 1982; and (3) comments January 17, 1983 in Ex Parte No. 436, Railroad Cost of Capital–1982, decision issued July 26, 1983.

Figure 1

Net Income U.S. Railroads

1971 - 1981 ($ Millions)

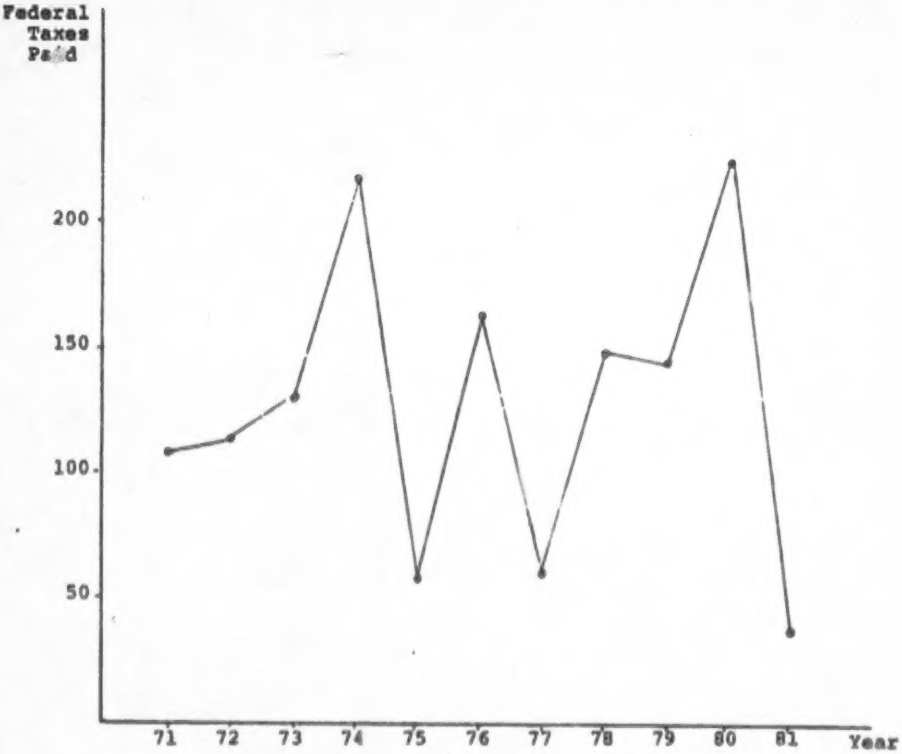


Source: The Economic ABZ's of the Railroad Industry, Association of American Railroads 1982, Table VI-3.

Figure 2

Federal Income Taxes Paid by U.S. Railroads

1971 - 1981 ($ Millions)



Source: The Economic ABZ's of the Railroad Industry, Association of American Railroads 1982, Table III-8.

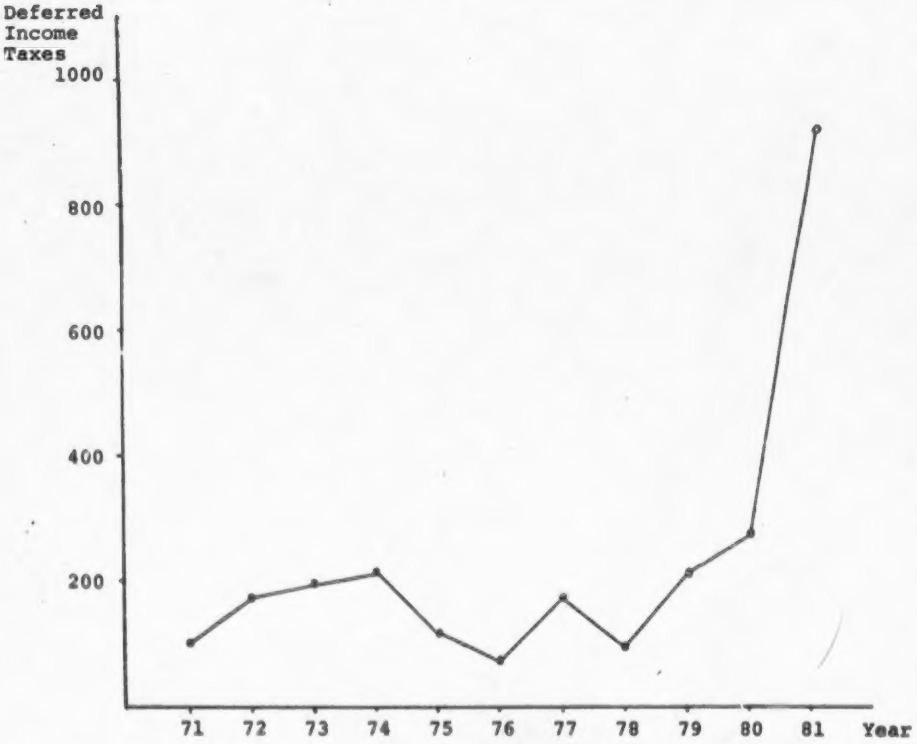
Significant tax breaks were provided by Congress in the Economic Recovery Tax Act of 1981. The three provisions which help the railroads most are ACRS, frozen base writeoff, and tax sale leasing. It must be noted that for 1981, the U.S. Treasury estimated that the railroads sold and leased back $1.766 billion of assets. The sale of the tax benefits associated with these assets brought the railroads $432.2 million in cash. Why would the railroads with a net income of $1.136 billion sell their tax benefits? The answer lies in the amount of taxes they paid as depicted in Figure 2. The railroads couldn't use all the benefits they had. So it made sense to sell the remainder.

The railroads made use of the other tax provisions as well. Figure 3 depicts the level of deferred income taxes. The immense increase in deferred taxes in 1981 is directly attributable to enactment of ERTA. It is likely that these taxes will be deferred indefinitely. On the railroads' financial statements these taxes appear as a liability; in reality they are an interest-free loan from other taxpayers.

Figure 3

Deferred Income Taxes U.S. Railroads

1971 - 1981 ($ Millions)



Source: *The Economic ABZ's of the Railroad Industry*, Association of American Railroads 1982, Table III-8.

The financial community is aware of the tax benefits and the true financial posture of the railroads. Table 1 is a list of the bond ratings of the railroads prepared by the AAR. It can be noted that many of the railroads are very healthy financially. Merrill Lynch, for example, in its May, 1983 Railroad Industry Quarterly Update states:

"Thus far in 1983, railroad stocks, as measured by the Standard & Poor's Rail index, have turned in a strong market performance. During the first quarter of 1983, the S&P Rail Index was up 13.6 percent compared with an 8.9 percent advance in the S&P 500 Index: and, through May 18, the 1983 gain in the Rail Index was 35.4 percent while the S&P 500 Index was up 16.2 percent."

Merrill Lynch further states:

"The financial condition of the railroad companies that we follow has been improving, a fact that becomes more impressive considering the overall decline of financial strength of industry in general during the recession."

Also, during the period 1976 through 1983, an investment in railroad securities produced on average a far greater yield than a comparable investment in industrial stocks. The Commission's determination that these very railroads are revenue inadequate stems from its choice of an inappropriate measure of revenue adequacy.

The Commission's proposed decision in Ex Parte No. 347 (Sub-No. 1) will lead to the railroads increasing the amount of noncompensatory traffic they carry and increasing their asset bases, not to the attainment of revenue adequacy as defined by the Commission.

TABLE 1.—RAILROAD BOND RATINGS VARY

Class I railroads	1975	1976	1977	1978	1979	1980	1981	October 1982
Atchison, Topeka & Santa Fe	AA	AA	AA	AA	AA	AA	AA	AA
Baltimore & Ohio RR	BB	BB	BB	BB	BBB	BBB	BBB	BBB
Boston & Marine Corp	DD	DD	D [1]	D	D	D	D	D
Burlington Northern	A	A	A	A	A	A	A	A
Chesapeake & Ohio Ry	A	A	A	A	A	A	A	A
Chicago & North Western Ry	B	B	B	B	B	B	B	B
Chicago, Milwaukee, St. Paul & Pacific	B	B	B	D	D	D	D	D
Chicago, Rock Island & Pacific	DDD	DDD	D [1]	D	D	D	D	D
Denver & Rio Grande Western	BBB	BBB	BBB	BBB	BBB	BBB	BBB	BBB
Florida East Coast Ry	BB	BB	BB	BB	BB	BB	BB	BB
Fort Worth & Denver Ry	BBB	BBB	BBB	BBB	BBB	BBB	BBB	BBB
Illinois Central Gulf	A	A	BBB	BBB	BBB	BB	BB	BB
Kansas City Southern	A	A	A	A	A	A	A	A
Louisville & Nashville RR	BBB	BBB	BBB	BBB	BBB	BBB	BBB	BBB
Missouri-Kansas-Texas	B	B	B	B	B	B	B	B
Missouri Pacific	BBB	BBB	BBB	A–	A–	A–	A–	A–
Norfolk & Western	AA	AA	AA	AA	AA	AA	AA	AA
St. Louis-San Francisco	BBB	BBB	BBB	BBB	BBB	BBB	A [2]	A [2]
St. Louis Southwestern	AA	AA	AA	AA	AA	AA	AA	AA
Seaboard Cost Line	A	A	A	A	A	A	A	A
Soo Line [3]	BBB	BBB	BBB	BBB	BBB	A	AA	AA
Southern Pacific	A	A	A	A	A	A	A	BBB
Southern Railway	A+	A+	A+	A+	A+	AA	AA	AA
Union Pacific RR	AA	AA	AA	AA	AA	AA	AA	AA
Western Pacific RR	BB	BB	BB	BB	BB	BB	BB	BB

[1] Consolidation of bankrupt issues into one category.

[2] Merged into Burlington Northern.

[3] Wisconsin Central first mortgage.

Source: Standard & Poor's Bond Guide, year end issues, May 1981 issue and October 1982 issue.

In the year the Staggers Act was passed, 1980, the salaries paid by many railroads including the Union Pacific suggest that the railroads did not consider themselves revenue inadequate. Using the Union Pacific as an example, it can be demonstrated that salaries for railroad executives and common employees were far from inadequate. According to the Union Pacific's March 6, 1981 Proxy Statement, the following officers received cash compensation in these amounts:

REMUNERATION TABLE

Name of individual and capacity in which served	Cash		Remuneration: Securities, property, insurance, or personal benefits	Aggregate of contingent forms of remuneration
	Salaries and directors' fees	Awards pursuant to executive incentive plan		
James H. Evans, director, chairman board of directors and chief executive officer of the company	$385,096	$550,000	$9,691	$10,200
William S. Cook, director, president and chief operating officer of the company	317,300	440,000	3,470	9,000
John C. Kenefick, director of the company and president of Union Pacific Railroad Co	248,625	325,000	5,408	7,050
William T. Smith, director of the company and president of Champlain Petroleum Co	228,400	325,000	4,249	9,280
William J. McDonald, senior vice president-law of the company	181,050	225,000	6,150	5,400

Source: UP Mar. 6, 1981, proxy statement at 13.

John C. Kenefick received $573,000 in direct cash compensation in 1980. The ability to pay such a high sum is hardly an indication that the UP is poverty struck.

These salaries have not diminished in the succeeding years. The May 9, 1983 issued of Business Week reported that the Chairman and Chief Executive Officer of Union Pacific Corporation, James H. Evans, was paid $835,000 in 1982. John C. Kenefick, Chairman and Chief Executive Officer of Union Pacific Railroad, was paid $533,000 in 1982.

Union Pacific Corporation executives have the further advantage of a generous stock option plan. According to the Proxy Statement, the top five officers have realized these net values in shares during the last five years immediately preceding the UP March 6, 1981 proxy statement:

	James H. Evans	William S. Cook	John C. Kenefick	William T. Smith	William J. McDonald
Net value realized in shares (market value less any exercise price) or cash	$1,954,200	$128,870	$2,480,035	$340,727	$1,654,830
Furthermore, those officers had respectively these potential values from stock options:					
Potential (unrealized), value (market value less exercise or base price)	$6,602,910	$6,566,140	$1,906,535	$2,284,160	$1,445,985

From the foregoing it is seen that average total annual compensation, including stock benefits, for Chairman Evans and President Cook of the parent Union Pacific Corporation exceeded $2,000,000 each while that of President Kenefick of the Union Pacific Railroad, President Smith of the affiliated Champlain Petroleum and Senior Vice President-Law McDonald of the parent Union Pacific Corporation exceeded $1,000,000.

This is I.C.C. revenue inadequacy.

The number of shares available for stock options was increased dramatically in 1982. The Union Pacific 1982 annual report indicates that at the end of 1982, 3,586,600 shares were available for grant. The figure at the end of 1981 was 488,550. During 1982, options on over one half million shares were given out by Union Pacific at prices between $31.00 and $51.13. If it is assumed that the average exercise price is $40, the recipients have a paper profit of about $10 million at the current market price of $60 per share. During 1982, option holders exercised options on over 188,000 shares at prices between $14.30 and $40.82.

Similarly, crew wages are extraordinarily high. The average annual wage of a Union Pacific employee on the litigated Hiawatha movement was $53,187.[9] The discrepancy between the wages paid Union Pacific employees and those paid in other industries was evidenced in that litigation: [10]

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[9] Verified Statement of Philip E. Corbin filed October 19, 1981 in Docket No. 37038, Bituminous Coal, Hiawatha, Utah to Moapa, Nevada, at 49.

[10] *Id.*, Table 2 and following text.

TABLE 2.—AVERAGE INDIVIDUAL WEEKLY EARNINGS BY PRIVATE INDUSTRY SECTOR, AS OF MAY 1981

Industry group	Wages
1. Mining	$423.98
2. Construction	388.56
3. Manufacturing	317.56
4. Wholesale and retail trade	188.48
5. Transportation and public utilities	376.89
6. Railroad transportation (Class I railroads)	446.04
7. Finance, insurance and real estate	205.73

Source: U.S. Department of Labor, Bureau of Labor Statistics, Employment and Earnings, August 1981.

The foregoing listed industry groups all show average weekly pay less than half that of the Union Pacific crew wage and it is evident that this is far more than any other production or non-supervisory worker on private non-agricultural payrolls in the entire United States. Indeed, wages paid to Union Pacific train crews handling Hiawatha coal surpass or approximate the pay of such highly trained and skilled professionals as federal judges, doctors or ICC Commissioners. Also, in the public sector, Union Pacific wages even exceed the wages demanded by members of the Professional Air Traffic Controllers Organization, now unemployed in part because of the U.S. Government's unwillingness to pay "excessive" wage demands. The Union Pacific wage also comes close to the current Congressional salary of $60,663. Another comparison can be drawn between U.S. Census earnings data for railroad personnel and Union Pacific crews handling Hiawatha coal. (*Id.* at 49-50.)

This is I.C.C. revenue inadequacy.

4. Railroad acquisitions

In fact, it is likely that quite a few railroads are currently revenue adequate and unable to employ the profits and depreciation which they are producing. This view is supported by the many nonrailroad acquisitions which the railroads are making. It must be remembered that most railroads which are parts of larger organizations provided the capital to build the nonrailroad operations. Some railroads are currently financially healthy enough to be acquiring other assets and corporations. In effect, the railroad assets and earnings power have enabled most railroads to acquire subsidiaries in other lines of business. Recently, CSX has offered to acquire Texas Gas Resources Corporation for about $1 billion. This comes on the heels of the acquisition of El Paso Natural Gas for about $600 million by Burlington Northern. Norfolk and Western also bid for a large part of Piedmont Airlines. The parent holding companies of these railroads built themselves up at the expense of the railroads as noted below. The building has not stopped. The proposed decision in Ex Parte No. 347 will, if anything, enable the railroads to accelerate the types of activities described above.

5. Railroad holding companies

As noted above, most railroad holding companies acquired their other assets directly or indirectly through stripping off railroad assets. The methods used to accomplish this result are detailed in Railroad Conglomerates & Other Corporate Structures, A Report to Congress as Directed by § 903 of the Railroad Revitalization and Regulatory Reform Act of 1976, I.C.C., Feb. 5, 1977.

The Railroad Conglomerates report should be used as a beginning point, and updated, and expanded, for determination of the extent to which the revenue adequacy of rail carriers has been unduly influenced by affiliate transactions. As an indication of the potential for influencing revenue adequacy generally and in turn, coal rates, there are set forth below excerpts from the Conglomerates report:

"*Formation of Holding Companies.*—From proxy statements to their stockholders, prospectuses and statements to the Commission, the following holding companies stated that one of the reasons for forming a holding company was to avoid ICC regulations: Santa Fe Industries, Inc., Southern Pacific Company, Katy Industries, Inc., Chessie System, Inc., Rio Grande Industries, Inc., Western Pacific Industries, Inc., Kansas City Southern Industries, Inc., Union Pacific Corporation.

"UPC stated that the separation of the railroad from other lines of business insulates the carriers from the higher risks involved in nonrail enterprises.

"What was left unsaid is that the holding company also insulates the railroad from any profits generated by assets and companies transferred from the railroad to the holding company. P. 10."

The Rail Conglomerates report also details the extent to which railroads affiliated with conglomerates purchase services and goods from the parent corporation, e.g., fuel purchased by the Union Pacific from Champlin Petroleum. Additionally, railroad assets have often been transferred to nonrailroad affiliates at below fair market value or without compensation. The report notes:

"Through a process of 'corporate reorganization' or 'restructuring' and subsequent dividends, several of the respondent railroad companies conveyed nontransportation and other assets currently worth billions of dollars to their parent holding companies. Some respondents have stated that these assets—principally land, natural resources, operating companies, and securities—were removed from the railroads in order to foster their profitable development free of regulatory restrictions and with no capital risks to the railroads. However, the loss of these assets has diminished current and potential earnings of the affected railroads and diverted income that was formerly used or available for transportation purposes by the railroads to the holding companies or other nontransportation affiliates."

The Rail Conglomerates report concludes with the observation that there should be concern about the railroads transferring lands which were granted by the Federal government to enable railroads to find the construction and operation of their rail lines. The report finds:

"Were the railroads receiving these properties, or their railroad successors in interest, to be deprived of the fruits of these land grants at a time, whether now or in the future, when they are needed to support rail services essential to the public interest, the intention of the Congress in making these grants would be subverted, and today's citizens would lose the benefit of the contract made by their forebears with the land-grant railroads. P. 74."

In view of the above-quoted findings and conclusions, as well as other similar ones throughout the Railroad Conglomerates report, railroads which are parts of conglomerates ought not be allowed to engage in rate gouging of captive coal shippers through the exaction of differential pricing additives over and above the fully allocated cost, including a return on capital, in the absence of a conclusive showing that intercorporate transactions have not adversely affected the carrier's earnings abilities.

B. COAL RATE GUIDELINES

The Interstate Commerce Commission issued a decision on February 24, 1983 in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines-Nationwide.

The proposed decision in Ex Parte 347 (Sub-No. 1) allows railroads to charge captive coal shippers up to stand-alone costs subject to several constraints. Stand-alone costs are defined as what it would cost the coal shipper to build and operate the railroad for itself. The Commission's choice of stand-alone costs as a method of regulating railroad pricing is at best a dereliction of the duty to ensure just and reasonable rates for rail traffic. At worst, allowing stand-alone costing is further evidence that the Commission is biased in favor of the railroads in this and other rail ratemaking proceedings. This section details the impropriety of using the stand-alone method. Included in the discussion is a description of what stand-alone costs mean for a shipper such as Nevada Power and the way railroads can manipulate the stand-alone method for their own benefit.

1. Stand-alone method is improper in this context

The Commission recognizes that, left to their own devices, the railroads would engage in monopoly pricing of railroad services. This would result in higher prices, less output and a significant loss of consumer welfare. The Commission, therefore, endorsed Ramsey pricing as a theory to avoid the troubling features of monopoly pricing. Finding that their original choice, Ramsey pricing, is difficult if not impossible to administer, the Commission proposes to employ stand-alone costing as an alternative to Ramsey pricing and as a constraint on the rates railroads can charge shippers. However, under economic theory, it is impossible for stand-alone cost to be a surrogate for Ramsey pricing.[11]

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[11] Verified Statement of Dr. George Rhodes on behalf of Nevada Power Company in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines-Nationwide, filed July 28, 1983 at 2.

2. Example of economic effects of stand-alone costs: Nevada Power Co.

The Commission has proposed stand-alone costs as the maximum to which coal transportation rates can rise. Stand-alone cost is the cost for the shipper to provide the railroads itself. In 1982 Nevada Power Company shipped about one million tons of coal to its generating plants in Southern Nevada via several western railroads including the Union Pacific.[12]

To determine the effects of the Commission's proposed decision, Nevada Power calculated that the stand-alone cost per ton for its coal movement would be $181.95. This is 13 times greater than the present rate of $13.29.[13] This present rate exceeds full cost, including a return on capital, by $5.00 per ton. Because the Commission refuses to carry out its statutory mandate, Nevada Power and Indianapolis Power & Light customers are paying more for electricity than is proper due to high coal rail rates.

If the Commission were to allow the railroads serving Nevada Power to charge a rate of $181.95, "the mark-up in profit would be over 20 times their full cost of service."[14] This is equivalent to a profit margin in excess of 1900 percent, and would impose an unconscionable burden upon electric ratepayers.[15]

"Based on a 1982 annual shipment volume of 1,141,714 net tons, the additional financial burden in excess of present rate levels that would be placed on Nevada Power Company and its ratepayers under the stand-alone cost concept would exceed $192,000,000 per year."

Way and structures account for most of the stand-alone cost. Total annual stand-alone costs for Nevada Power would be about $208 million, of which $190 million represents way and structures. It must be remembered that (1) way and structures costs are sunk costs and (2) the railroads in the west are largely entities which owe their existence to the largess of the government and people of the United States. The construction of the western railroads was based on the extensive land and mineral gifts to the railroads. The Commission is currently attempting to charge the taxpayer for something for which he has already paid in the form of land grants to the railroads.

3. The Long-Cannon amendment must be considered

The Long-Cannon Amendment to the Staggers Act[16] requires the Commission to minimize rail traffic which does not compensate the railroad for the cost of transporting the traffic. It is because the railroads transport so much noncompensatory traffic that they are seeking higher rates on captive traffic like coal. The Commission's 1982 Waybill tape indicates that the amount of noncompensatory traffic increased from 31 percent in 1977 to 32 percent in 1981.[17] Thus it appears that the railroads have used their new Staggers Act freedoms to increase their predatory intermodal raids on competitive traffic at the expense of captive shippers. Under the Long-Cannon Amendment, the Commission is required to consider reduction of noncompensatory traffic as an alternative to substantially increasing rates on coal traffic. It must also consider maximizing revenues on competitive traffic and whether it is unreasonable to burden coal, alone, or in conjunction with other captive commodities, with the carriers' revenue shortfalls.

The proposed decision emasculates the Long-Cannon Amendment. The Commission pays lip service to the Long-Cannon Amendment by indicating that management efficiencies will be considered as a constraint to railroad pricing decisions. The essential problem with the Commission's approach to examining management efficiencies is that it places the burden for proving pricing inefficiency on the shippers when the railroads have most if not all of the information necessary to prove inefficiency. When a shipper attempts to meet this burden of proof and seeks information from the railroads, the shipper meets resistance from both the railroads and the Commission. This is directly contrary to the intent of Congress that the carriers have the burden of proving compliance with the Long-Cannon Amendment, as stated by Senator Russell B. Long at the Legislative Oversight Hearings of the Surface Transportation Subcommittee of the Senate Commerce, Science and Transportation Committee on July 26, 1983.

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[12] Starting in 1983, Nevada Power will ship about 2 million tons per year.

[13] Verified Statement of Philip E. Corbin on behalf of Nevada Power Company in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines-Nationwide, filed April 28, 1983.

[14] Id. at 10.

[15] Id. at 37.

[16] 49 U.S.C. § 10707(a)(e)(2)(C).

[17] Verified Statement of Philip E. Corbin in Ex Parte No. 399, Cost Recovery Percentage by Nevada Power Company, April 28, 1983 at 13.

Thus, for the Commission to suggest that it has attempted evenhandedly to administer the Staggers Act is nonsense. Even the I.C.C.'s General Counsel in reviewing the proposed decision wonders, "what actions will Commission take to enforce Long/Cannon?" (See Appendix B.) This lack of evenhandedness carries over to the Commission's proposed decision. To allow railroads to increase coal rates by 15 percent per year plus inflation will provide them with an incentive to increase the amount of noncompensatory traffic they carry. The Commission is providing the railroads with an incentive to act contrary to the Long-Cannon Amendment of the Staggers Act. To restrain such railroad behavior, the Commission offers a vague constraint of efficiency that has proved wholly ineffective in the past, largely through the action or inaction of the Commission itself.[18]

The Commission no doubt wishes that the Long-Cannon Amendment was not law. The Commission certainly didn't lobby for the inclusion of the Long-Cannon Amendment in the Staggers Act. But it is law and the Commission has a duty to fairly administer the whole Act. The proposed decision cannot be construed as an evenhanded attempt at that goal. The Commission has not fairly considered alternatives which would allow revenue adequacy while at the same time curbing the inefficiencies associated with the growing level of noncompensatory traffic. In a truly competitive environment, the railroads would be better off dropping a significant proportion of their noncompensatory traffic. It is only because of the unwarranted revenues they are allowed to reap from captive traffic such as coal that railroads find it advantageous to carry such noncompensatory traffic. Indeed, they would be required to survive in a competitive marketplace. The Commission's proposed decision would only make this situation worse.

Failure to require carriers to prove compliance with the Long-Cannon criteria, as a condition precedent to pricing above the jurisdictional threshold, constitutes gross dereliction of a statutory duty and willful refusal by the Commissioners to obey the oath of office to uphold the laws of the United States.

4. The stand-alone method will worsen the current cross-subsidization of competitive traffic by captive traffic

Railroads have been given great latitude in pricing traffic by the 4-R and Staggers Acts. Railroads have used this latitude to increase their volume of competitive traffic at the expense of captive traffic. Railroads have increased prices more on captive traffic than on competitive traffic since 1980. What the railroads are doing is using excessive revenues generated on captive traffic to subsidize competitive traffic.

There is a wide range in the price increases of individual commodity groups between 1980 and 1983. The smallest increase—trailer on flat car and container on flat car—is less than one half the highest increase—waste and scrap materials. It is interesting to note that the lowest price increase is exhibited by the category of traffic that is in the greatest competition with the trucking industry. If a trailer doesn't move on a flat car (TOFC) it is a simple matter to transport it over the roads. In fact, TOFC traffic rolls off the railroads and onto the roads. At the other end of the spectrum are captive commodities like waste and scrap materials and coal. The Commission's proposed decision in Ex Parte No. 347 (Sub-No. 1) will only exacerbate this.

The Interstate Commerce Commission's General Counsel recognizes this. In a memo about the proposed decision in Ex Parte No. 347, the General Counsel states: [19]

"Extremely naive to say (p. 22) that RRs will not price competitive traffic (less than) cost if they can charge (greater than) cost on captive traffic.

"The revenue adequacy 'constraint' will bring little comfort to shippers."

a. Short-run effects of the Commission's proposed decision

In the short-run the Commission's decision would provide the railroads with a greater opportunity to increase their cross-subsidization of competitive traffic.

This cross-subsidization can lead to below marginal cost pricing in competitive markets in order to expand, in the long-run, the rate base on which railroads can earn profits.

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[18] The Commission has denied a petition by shippers to institute a rulemaking on the Long-Cannon Amendment for the purpose of establishing a means for its implementation.

[19] See Appendix B. (Retained in committee files.)

b. Long-run effects of the Commission's decision

The same circumstances which produce cross-subsidization in the short-run will produce over-expansion of the railroad rate bases in the long-run. If the railroads' freedom to exact higher prices is constrained only by the standard of an overall rate of return not to exceed the current cost of capital, then they will be able to manipulate their rate of return so as to avoid that constraint while at the same time increasing the total dollar return. They will be able to do this by expanding the size of their rate base in order to increase total dollar profits and still earn a rate of return just below or equal to the regulated rate.[20]

In the long-run, the railroad will expand its rate base to the point where it is between economic viability and obsolescence. At this point, profit maximizing prices will have to be charged in all markets to reach revenue adequacy. Higher prices reduce consumer welfare and when a railroad charges profit maximizing rates, the total amount of consumer welfare is reduced.

The adverse effects of revenue adequacy as a standard ion both short- and long-haul transportation are due to the improper use of the current cost of capital as the sole criterion for determining revenue adequacy by the Commission. The railroads will be led to increase their rate base in an attempt to increase profits. This effect can be avoided only by appraisal of each railroad's overall financial health, including all of the conventional financial ratios, and the efforts made to rationalize the rate base.

C. THERE IS A NEED FOR RAILROAD COST STUDIES

There is insufficient evidence to support the Commission's assertion that the railroads exhibit economies of scale. If economies of scale do not exist, there is no economic basis to use demand based pricing in place of the traditional cost based pricing. Similarly, the need for cost studies arises in determining whether the railroads have achieved revenue adequacy. Finally, insufficient attention has been given to the concept of sunk cost in the railroad industry. Way and structure is a classic example of sunk cost since as capital it has little or no alternative-use market value, will remain in existence for a very long time, and cannot be transferred to other services within the rail network should demand conditions change.

Only if the Commission is able to satisfy itself through appropriate analysis that (1) the railroads are revenue inadequate and (2) economies of scale are present, can it reasonably proceed to a form of demand based ratemaking. Given this, it has been demonstrated above that the Commission's present method of demand based ratemaking is arbitrary. Alternatives to the proposed decision must be sought.

OTHER COMMISSION PROCEEDING AND PRACTICES

There are a number of other Commission proceedings and practices which affect ratemaking and therefore the cost of coal consumed by utilities and other captive coal shippers. This section details several proceedings and policies which must be considered.

1. Ex parte No. 387, railroad transportation contracts

The Commission currently allows contract rates to be filed irrespective of rate levels. This is an invitation to sub-optimal and/or predatory pricing which leads to further subsidy being extracted from captive coal traffic. Keeping these rates confidential assures that the carriers will be able to conduct such operations with impunity which they might not otherwise do if they were subject to public scrutiny. Disclosure of pricing activities of a regulated monopolist tends to have at least some policing effect. Keeping them out of the public domain tends to increase the suspicion of coal shippers, producers and planners and accelerate the flight from coal.

2. Ex parte No. 320 (sub-No. 2), market dominance determinations and consideration of product competition

The concept of market dominance was considered in Ex Parte No. (Sub-No. 2), Market Dominance Determinations and Consideration of Product Competition. The Commission discontinued the use of rebuttable presumptions as to the existence of market dominance as a tool and replaced the rebuttal presumptions with general guidelines. The Commission decided to continue to include geographic and product competition as evidentiary tools in market dominance determinations. The Commission's assessment of the concept of product competition was incomplete and decided incorrectly. This continues to influence individual coal rates and the present proceeding in general.

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[20] This has come to be called the "Averch-Johnson Effect." See H. Averch and L. Johnson, "Behavior of the Firm Under Regulatory Constraint," American Economic Review, December 1962.

3. Ex parte No. 355, cost standards

The Commission's decision in Ex Parte No. 355, Cost Standards will adversely affect the shippers of coal. In this decision the Commission allowed minimum rail rates for noncaptive traffic to fall below, apparently far below, Rail Form A variable costs to some vague indefinite level. The Commission, as a matter of policy, has refrained from defining this level but has left captive coal shippers responsible for supplying any revenue shortfalls resulting from predatory or otherwise unprofitable prices on noncaptive traffic.

4. Commission policy of protracted delay and failure to set base rates

The Commission has adopted a policy of taking indefinite periods of time for consideration or remanded cases. Unreduced rail rates continue to be charged in these cases while they are pending. This materially affects long-range planning and thereby adversely affects environment and energy policies. The I.C.C. disregards on remand, whether as a consequence of court reversal or voluntary recall by the I.C.C., the time limitations that apply in initial investigation cases; thus the five-month intended congressional limitation can be strung out over many years. This is contrary to the rail transportation policy for expeditious decisions and to the spirit of the statute requiring reconsideration in 120 days.

This appendix presents a commentary on sections of the Staggers Act which need to be amended if the Act is not repealed in its entirety. These sections were briefly described and asterisked in Section II above.

1. SECTION 201—REGULATION OF RAILROAD RATES

In Ex Parte No. 355, Cost Standards for Railroad Rates,[1] the I.C.C. established minimum rate standards so low on competitive traffic as to require subsidy by captive traffic. It utilized flow-through of deferred taxes to further depress minimum rate levels in Ex Parte No. 355 while it retained deferred taxes in the rate base to inflate maximum rate determinations in Ex Parte No. 347 (Sub-No. 1),[2] and Ex Parte No. 393.

It is essential that Congress define minimum rate standards so that competitive traffic pays for itself.

2. SECTION 202—DETERMINATION OF MARKET DOMINANCE, JURISDICTIONAL THRESHOLD, AND USE OF THE TERM VARIABLE COST

a. Determination of jurisdictional threshold

This section poses a whole host of philosophical and interpretive problems.

First and foremost is the problem that it places a premium on inflation of variable costs, thereby reducing the ratio of rate to variable costs, so as to diminish regualory jurisdiction.

In Ex Parte No. 399, Cost Recovery Percentage, the I.C.C. used several procedures to improperly distort and inflate the cost recovery percentage which ultimately will be used as the juridictional threshold. First, it has indiscriminately used the Kearney Study which was thoroughly discredited in Ex Parte No. 320 (Sub-No. 1), Rail Market Dominance and Related Considerations, where the Commission warned about technical limitations in the Kearney Study with respect to data errors and omissions, sampling accuracy and that "revenue-cost ratios on coal movements are misleading." In Ex Parte No. 355, Cost Standards, the Commission disavowed the Kearney Study where its use would have resulted in higher minimum rates than the Commission ultimately decided.

Notwithstanding this, the I.C.C. in Ex Parte No. 399 used the Kerney Study to inflate the maximum rates allowed, attaching a portion of the Kearney Study as an appendix to its notice, altering the document to delete the caveat "file contains errors." In other words, the I.C.C. uses or rejects the Kearney Study depending on whether its purpose is to inflate maximum rates (Ex Parte No. 399) or decrease minimum rates (Ex Parte No. 355) and in the process alters a document to conceal a serious shortcoming. This typifies the perversity of the I.C.C.'s rulemaking proposals and its desperation to justify higher rail rates no matter what the rule facts and the law are. Where is the public conscience?

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[1] 362 I.C.C. 800, 812 (July 9, 1980), as modified at 364 I.C.C. 898 (May 12, 1981).

[2] See comments of Nevada Power Company filed May 11, 1981.

Second, the Commission improperly included noncompensatory traffic. Third, the Commission arbitrarily excluded other traffic.

In Ex Parte No. 320 (Sub-No. 2), Market Dominance Determinations and Consideration of Product Competition,[3] the I.C.C. has inexplicably abandoned its previous procedures for determination of market dominance, which involved three fairly well-defined rebuttable presumptions with respect to market share, ratio of rate to cost, and substantial shipper investment, and instead substituted considerations of product and geographic competition. It has adopted these vague and troubling concepts after having professed difficulty in applying the fairly well-defined pre-existing presumptions. Most strangely, it has injected product competition into market dominance determinations in the face of the express prohibition against doing so in § 205 of the Staggers Act. It did correctly disavow that which § 205 would allow, but not require, namely consideration of product competition with respect to rate reasonableness.[4] Product competition is not an appropriate consideration for either market dominance or rate reasonableness.

b. Jurisdictional thresholds produce exorbitant rates of return on rate base and equity

The increasing jurisdictional thresholds result in such an enormous rate of return on captive traffic as to suggest that this effect was either unknown or not understood by Congress at the time of enactment of the Staggers Act.

The jurisdictional threshold automatically rises by five percentage points annually, starting on October 1, 1980 at 160 percent, and ending at 175 percent on October 1, 1984. After that date, the jurisdictional threshold will be equivalent to the Cost Recovery Percentage (CPR), which will be a number calculated by the Commission within the range of 170 percent to 180 percent.

An illustration of the pre-tax rate of return on equity, excluding deferred taxes, generated by these jurisdictional threshold ratios in the year 1980 is shown for the Union Pacific Railroad which serves Nevada Power Company.

The UP would only be required to have a revenue to variable cost ratio of 141.6 percent in order to earn the I.C.C.'s determined 19 percent rate of return. This rate of return was derived by the I.C.C. through assumption of a statutory tax rate of 46 percent which grossly overstates the tax actually paid by rail conglomerates. At 160 percent of variable cost, the return on stockholders' equity before tax would be 44.43 percent. At 170 percent the pre-tax return on equity would be 55 percent. At 180 percent of variable cost, the return on stockholders' equity before tax would be 65.56 percent. From this it can be seen that even assuming the statutory tax rate of 46 percent the UP would earn a substantial subsidy at any of the jurisdictional thresholds contined in the Staggers Act.[5]

These figures are provided with respect to the UP because they are readily available as examples of the enormous return the jurisdictional thresholds generate, and the enormous burden they will place upon captive traffic. Similar returns would be realized by other railroads. Notwithstanding the enormous rates of return generated by, and burdens placed upon, captive traffic as the jurisdictional threshold is phased upward over a four-year period from 160 to 180 percent, the Commission plunged ahead with its proposals in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines—Nationwide, for new methods of maximum rate determinations which would eclipse even the extraodinarily high jurisdictional thresholds establish by Congress. In its December 16, 1981 decision it proposed to use ton/ton-mile costing which would result in rates ranging from 180 to 225 percent of variable cost or higher. Now in its February 24, 1983 decision it proposes increases of 15 percent per year until the shippers can build their own railroad.

The Staggers Act is programmed to provide an astonishing rate of return. Without conceding the propriety of the legislative taking from the captive shippers which inheres in such enormous returns, the very enormity of the level of return which would be generated by the ultimate jurisdictional threshold serves to reenforce the legislative mandate, apparent on the face of the Act, and carefully explained by the Congressional sponsors, that rates be phased up gradually in accordance with the jurisdictional thresholds in the absence of a clear and convincing demonstration by carriers that they have complied with the Long-Cannon criteria. Instead, the I.C.C. has proposed to raise coal rates to levels which would automatically eclipse the statutory framework of jurisdictional thresholds, zone of rate flexibility increases, and Long-Cannon criteria. In the process, the I.C.C. would effectively re-write the law to eliminate the protections that Congress intended.

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[3] This decision is now pending judicial review in the U.S. Court of Appeals for the Fifth Circuit in *Western Coal Traffic League* v. *United States*, Nos. 81-4257 et al.

[4] See comments of Nevada Power Co. filed February 17, 1981.

[5] Verified Statement Charles L. Carroll, p. 12, Opening Statement of Facts and Argument of Nevada Power Co. on Reopening filed November 9, 1981, in I.C.C. Docket No. 37038, Bituminous Coal, Hiawatha, Utah to Moapa, Nevada.

c. *The definition and use of the term "variable cost" in the statute is vague and indefinite*

The definition and use of the term "variable cost" in the statute is vague and indefinite, perhaps incurably so.

Section 202 of the Staggers Act provides that: "[v]ariable costs shall be determined pursuant to section 10705a(m)(1) of this title, with adjustments specified by the Commission." 49 U.S.C. § 10709(d)(3).

The statute fails to set forth standards for "adjustments specified by the Commission." Moreover, section 10705a(m)(1) is equally vague and indefinite in that it provides that: "[v]ariable costs . . . shall be determined . . . by . . . unadjusted costs calculated using the Commission's Rail Form A cost finding methodology *(or an alternative methodology adopted by the Commission in lieu thereof).*" [Emphasis added.]

Nor does the statute set forth standards for "an alternate methodology adopted by the Commission in lieu thereof." Thus, apparently "variable cost" may mean anything the Commission determines. But the Conference Report stated: "The Conferees do not intend that the Commission alter the jurisdictional threshold by reducing the items which will be considered as part of the variable cost." [Id. at 91.]

This clearly means that the I.C.C. is not to increase its jurisdiction by reducing items included in variable cost. Thus the I.C.C. may not redefine variable costs so as to exercise jurisdiction over lower rate levels.

May the I.C.C. do the opposite, namely increase the items considered as a part of the variable cost thereby diminishing its jurisdiction and allowing rate levels to rise? The Report expressed no intention in this regard.

The I.C.C. proposes to adopt the Uniform Rail Costing System (URCS) which will effectively change the jurisdictional threshold unless adjusted to RFA comparability. But the changed accounting system makes calculation of current RFA costs extremely difficult, if not impossible, without access to carrier internal financial data.

Either the results must be the same as they would have been at the time of enactment of the statute or the statute is incurably vague, indefinite, and one-sided.

While it might be permissible in some other context to permit a regulatory agency to define variable cost in whatever manner that it saw fit, it is incongruous and of dubious propriety to do so in the context of a statute which purports to define the jurisdiction of an agency in terms of fixed percents of such variable costs. The statutory jurisdictional threshold percents would be meaningless in the face of I.C.C. authority to redefine variable costs as it pleases.[6]

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[6] The goal of development of movement-specific costs which appears to be mandated by the requirement to: "[e]stablish principles governing the determination of economically accurate . . . railroad costs directly and indirectly associated with particular movements of goods, including the variable costs associated with particular movements of goods or such other costs as the Board believes most accurately represent the economic costs of such movements." 49 U.S.C. § 11162(a).

This would seemingly result in the increased variability of costs, which would work at cross purposes with the requirement that:

(b) in developing cost accounting principles under this section, the Board shall take into account all the following considerations:

(1) The specific regulatory purposes for which railroad costs are required.

(2) The degree of accuracy of the cost information which is needed to meet regulatory purposes. 49 U.S.C. § 11162.

Since it would seem to be a required and specific regulatory purpose to develop costs in a manner reflective of variability levels in effect at the time of enactment of the percentage jurisdictional thresholds in the Staggers Act.

3. SECTION 205—RATE REGULATION PROCEEDINGS; ADEQUATE REVENUE

"The revenue provisions of Section 205 have been abused by the Commission, which improperly utilizes the current cost of capital as its sole standard of revenue adequacy."

Aside from the Commission's strange interpretation of the "product competition" provisions of this Section, it has further interpreted this Section to require redefinition of its standards of railroad revenue adequacy.

In Ex Parte No. 393, Standards for Railroad Revenue Adequacy,[7] it abandoned all of the long-standing indicators by which revenue adequacy is tested and adopted as the sole determinant the current cost of capital, thereby enabling the Commission to find that no major carriers enjoy revenue adequacy. By this contortion, the Commission declared inadequate the revenues of completely healthy carriers, thereby enabling them to lay claim to numerous increased-pricing privileges accorded by the statute only to revenue-inadequate carriers. The legislative history fails to disclose any contemplation by Congress of this gross perversion by the I.C.C. of the concept of revenue adequacy. Its action ignores all of the other generally accepted standards for determination of corporate financial health, including rate of return on equity, throw-off to debt ratio, rate of return on total capitalization, and fixed and contingent charge coverage.

The Commission, contrary to the practice of every regulatory agency in this country, uses the current cost of debt to calculate the current cost of capital, thereby giving equity holders a bonus. (See Ex Parte No. 347.) This practice is contrary to 49 U.S.C. § 10704(a)(2) which speaks only of a "reasonable and economic profit."

4. SECTIONS 203 AND 206—INFLATION-BASED RATE INCREASES

"The inflation-based rate increases of Sections 203 and 206 have been wrongly interpreted to require a price index without adjustment for productivity. The consequence is that shippers pay rates in excess of actual cost increases to the railroads."

In Ex Parte No. 290 (Sub-No. 2), Railroad Cost Recovery Procedures, the Commission issued an order (364 I.C.C. 841 (1981)) adopting as the inflation index mandated in Section 203(a) of the Act (49 U.S.C. § 10707(a)(2)(B)) a composite index based on the AAR Price Index and the Producer Price Index. The U.S. Court of Appeals for the D.C. Circuit upheld this order in *Western Coal Traffic League* v. *United States,* Nos. 81-1437 et al., issued on May 4, 1982.

Shippers criticized the I.C.C.'s decision to calculate the cost adjustment factor by using a composite price index instead of a cost index which would more accurately reflect the actual costs and the effect of inflation on those costs. Financial headway made against inflation by improved productivity and reduced costs created by larger traffic volumes are not reflected in the index chosen by the Commission. Additionally, decreases in the rate of inflation are not passed through to shippers in the quarterly applications of this index to shippers' rates.

The Court's affirmation of this decision point directly to a fatal flaw in the Staggers Rail Act, since the Court determined that the Commission's action was within the bounds of the Act. The Act thus deliberately permits the I.C.C. to tilt the scales of justice in favor of the carriers, contrary to the stated goal and purpose, set forth in Section 3 of the Act, "to provide a regulatory process that balances the needs of carriers, shippers, and the public."

Congress should rephrase Section 203 of the Act so as to require consideration of increased productivity when measuring increased costs and the impact of inflation on those costs.

5. SECTION 208—CONTRACTS

"The essential terms of rail contracts should not be confidential."

In Ex Parte No. 387, Railroad Transportation Contracts, the Commission ignored the statutory requirement that "the essential terms of the contract are available to the general public," treating most of the essential terms as confidential, thereby encouraging favoritism, discrimination and the growth of monopoly power, both among carriers and shippers.

To the extent that the Commission has made limited disclosure of the terms or rail rate contracts, such disclosure fails to indicate the extent to which such contracts may have been competitively inspired.

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[7] In *Bessemer and Lake Erie Railroad Co.* v. *Interstate Commerce Commission,* No. 81-1492 (10th Cir., Oct. 19, 1982), the Court upheld the Commission's decision "in all respects."

Principally, the coal contracts involve eastern railroads which usually have higher costs than the western railroads. The summaries generally fail to provide sufficient information concerning rates and operating conditions from which the reasonableness of the contract rates can be ascertained. There are a number of examples of contracts tying in with rail-owned loading, unloading, or port berthing facilities with the contracted volume at such a level so as to preclude or limit the use of the tied-in facility by other shippers and carriers.[8]

Instead of leading to competitive pricing, secret rail contract ratemaking may degenerate into predatory pricing, destructive competition, discriminatory pricing and rebates, and evasion of the anit-trust laws at the expense of captive coal shippers and the national energy policy.

To the extent that rail rate contracts are offered to captive shippers of coal, they are generally offered by the railroads on a take-it or leave-it basis. Rail rate contracts definitely do not provide any solution for captive traffic.

Rail rate contracts are not available on reasonable terms to captive shippers since there is neither the incentive for carriers nor the requirement that such contracts be offered. In practice, the statutory schemework, implemented by the Commission, is a disincentive to the use of contract rates for captive traffic. Since the jurisdictional thresholds and the Commission's ratemaking proposals set rate floors and not rate ceilings, carriers are unwilling to subject themselves to contractual restraints upon their rate levels.

6. SECTION 213—EXEMPTIONS

a. Long and short-haul exemption

Although Congress carefully considered the long- and short-haul clause and determined to repeal only a limited portion in Section 220, the Commission invoked its general exemption authority under Section 213 to nullify not only the statute but also long established case law by means of the rulemaking proposal in Ex Parte No. 346 (Sub-No. 3), Rail General Exemption Authority: Long and Short Haul Transportation. The I.C.C. has exceeded its general exemption authority in nullifying, in major part, the long and short-haul and aggregate of intermediate clauses and in reversing, by implication, a decision of the Supreme Court, which held:

"Apart from statutory enactment it is prima facie unreasonable to charge more for a shorter than for a longer haul. To charge more for a through haul than the aggregate of the intermediate rates is likewise prima facie unreasonable. *Patterson* v. *Louisville & N.R. Co.,*" 269 U.S. 1, 70 L.Ed. 131, 137 (1925).

The I.C.C. justified its action by suppositions and rationalizations having no support in the record, and which are founded instead upon misrepresentations and perversions of facts.[9]

An example of a misrepresentation is the I.C.C. statement that "the protest procedure . . . poses an unneeded barrier to carrier pricing flexibility." In fact, there was not even one protest filed against the 94 applications for relief processed in fiscal 1981. An example of perversion of fact is the claim "that the proposed exemption is limited in scope" based upon the fact that only 94 applications for relief were filed out of almost 55,000 tariffs. Indeed, the opposite is true. The I.C.C. would exempt some 54,000 tariffs which complied so as to eliminate the need for 94 applications for relief. Thus, it is seen that the need for exemption (94) is small, while the exemption (54,000) is large.

b. Export coal exemption.

In a decision served on June 9, 1983, in Ex Parte No. 346 (Sub-No. 7), Railroad Exemption-Export Coal, the Commission exempted rail export coal from regulation, effective September 12, 1983. In a three to one decision, the Commission held that regulation was not needed given the "relatively equal bargaining power of the involved parties." The majority also asserted that the large sunk costs of the railroads would prevent overcharging to the point of losing traffic for loss of traffic would cause economic hardship to the carriers.

The Commission's decision in this proceeding serves ony the railroads at the expense of the U.S. economy in general and coal producers in particular. The lone dissent in the decision was Chairman Taylor who correctly perceived that world competition for coal had little if any bearing on domestic competition for transport of coal for export. He noted that to remove regulation will lead to an abuse of market power by the railroads. The end result of this abuse of market power by railroads will be (1) much higher rail rates for export coal, (2) reduced export of coal, (3) a severe misallocation of resources, and (4) an increase in the imbalance of U.S. foreign trade.

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[8] See summaries of coal contracts disseminated by the I.C.C.'s Contract Advisory Service.

[9] See petition to reopen filed, March 28, 1983, by Nevada Power Co.

This decision must be reversed legislatively if the U.S. is to improve the use of one of its resources, coal. Failure to remove this self-imposed barrier to export benefits no one but the railroads while injuring coal producers, consumers and the nation as a whole.

7. SECTION 214—INTRASTATE RATES

This section provides that a state authority may only exercise jurisdiction over intrastate transportation exclusively in accordance with standards and procedures applicable to regulation of rail carriers by the Interstate Commerce Commission. Furthermore, a state authority may not exercise any jurisdiction over general or inflation-based increases on fuel adjustment surcharges approved by the Interstate Commerce Commission.

Under these circumstances, a state authority acts as little more than a rubber stamp for Interstate Commerce Commission policy and decision-making. It is no surprise that only thirty-six states filed with the Interstate Commerce Commission for certification to retain jurisdiction over intrastate rail rates under the Staggers Act.

Aside from the constitutional question that this section has raised, there are other problems in connection with its application. Paragraph C of Section 214 provides railroads the right of appellate review before the I.C.C. of state decisions:

"(c) Any rail carrier providing transportation subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title may petition the Commission to review the decision of any State authority, in any administrative proceeding in which the lawfulness of an intrastate rate, classification, rule, or practice is determined on the grounds that the standards and procedures applied by the State were not in accordance with the provisions of this subtitle."

However, section 214 does not permit similar review by the Interstate Commerce Commission on behalf of shippers who may question an adverse ruling by a state authority on the same grounds. This lack of reciprocal appellate rights raises questions of fairness, if not constitutionality, and is apparently an oversight on the part of Congress.

8. SECTION 216—EFFICIENT MARKETING

The Commission has clearly abused the statutory intent through the combined effect of its actions in Docket No. 37517, Reduction of the Notice Period for Filing Railroad Tariffs, and Docket Ex Parte No. 398, Protests Against Tariffs and Rules of Practice Governing Procedures in Certain Suspension Matters.[10]

In the name of efficient marketing, Section 216 has reduced the time for effectiveness of rail rate actions from 30 days to 20 days for increased or new rates and 10 days for reduced rates. The Commission has modified its rules that formerly provided that protests should be filed not less than 5 days before the effective date of publications made on less than 30 days' notice, and provided that protests against rate changes filed on 20 days' notice shall reach the Commission at least 10 days before the proposed effective date. This action shortens the time for filing a protest from 15 to 10 days, making it virtually impossible in many cases for shippers to prepare and file an adequate protest.[11] Moreover, the Commission has construed out of existence the term "new rate" requiring 20 days' notice under the Staggers Act and issued rules which will enable carriers in the future to claim that most all rate publications are decreases entitled to only 10 days' advanced notice, rather than 20. The Commission has noted that "there is almost always some rate published and in effect which would be applicable to a given shipment" in view of the "more than 100 years the railroads have operated" and that "an extensive rate structure has evolved." It then cites a carrier publishing a lower commodity rate when a class rate is in existence as an instance of a reduced rate rather than a "new" rate.

Thus, the I.C.C. has defined out of existence the statutory term "new rate" and thereby apparently affords carriers the right to publish on 10 days' notice, as a rate reduction, an exorbitant annual volume coal unit-train rate, where there was previously on file nothing more than a single car class rate. This end result would be a gross perversion of the statutory intent and radical departure from past Commission decisions. The end result of this change would be that it would possible allow carriers in the future to file on 10 days' notice, rather than 20, rates such as those investigated in Docket No. 37038 *(Hiawatha)* and in Docket No. 37409 (*Acco*).[12] There would be, apparently, only 5 days tc protest, instead of the previous 18 days.

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[10] See comments in Docket No. 37517 and Petition to Reopen and Consolidate in Ex Parte 398, filed Jan. 26, 1981, by Nevada Power Co.

[11] When rates were filed on 30 days' notice, shippers had 18 days in which to protest.

The combined effect of the Commission's actions is to stifle the ability of shippers to assert their rights through the filing of protests.

9. SECTION 229—SAVINGS PROVISIONS

Congress should repeal § 229. Although labelled "savings provisions" that section saves nothing, but instead extinguishes the rights of shippers to complain about existing rates after a 180-day period. If the section is repealed, with the provision that existing complaints may be dismissed without prejudice, and shippers would be allowed to file complaints in the future, as they have always been able to do in the past, then the need for consideration of many of these complaints would undoubtedly disappear for the present and might never reappear.

Substantial delay has occurred in the Commission's handling of the Section 229 base rate cases. The I.C.C. blindly accepted the railroad's proposal to establish in these cases a bifurcated procedure, whereby the existence of market dominance is first litigated and then the reasonableness of the rate at issue is determined. Bifurcation of these proceedings has obfuscated, obstructed, and delayed the preparation of the shippers' cases, because, in the market dominance portion of those cases, shippers have been denied discovery. The railroads can produce their own cost evidence to negate market dominance, but shippers do not have access to this crucial cost evidence needed to make their case or to dispute the carriers' evidence.

Bifurcation perverts the statutory intent to place the burden of proof on the carriers

10. TWO BASIC PROCEDURAL PROBLEMS

The Commission has adopted two procedural practices which frustrate basic shippers' rights:

A. It has proposed major changes in ratemaking criteria in notices of proposed rulemaking and then proceeded to implement those changes, resulting in higher rate levels, in individual ratemaking cases prior not only to ultimate resolution, but also prior even to receiving comments in the rulemaking proceedings. For example, the proposals in Ex Parte Nos. 347 (Sub-No. 1) and 393 were implemented in the rate decision in the Acco case, thereby substantially inflating the maximum rate above that which would have been approved under existing standards. The interlocking and bootstrapping of cases unduly burdens shippers by requiring them to cover all bases in order to protect vital interests. Moreover, the implementation of changes in ratemaking proceedings, which are being concurrently proposed but have not yet been approved in rulemaking proceedings, is a radical departure from sound regulatory principles.

B. It has adopted a practice of issuance of notices of proposed guidelines or proposed policy rather than proposed rulemaking. Through this practice, it sets forth fuzzy statements, circumventing Staggers Act and Administrative Procedure Act requirements for standards and procedures, thereby enabling the Commission to do as it pleases without any cognizable standards by which its actions can to judged—for example, Ex Parte No. 320 (Sub-No. 2), Market Dominance Determinations and Consideration of Product Competition, and Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines Nationwide.

These practices should be terminated.

STATEMENT OF D. K. MCNEAR, CHAIRMAN, SOUTHERN PACIFIC TRANSPORTATION CO.

Southern Pacific Transportation Company appreciates the opportunity to file this statement concerning the impact of the Staggers Rail Act of 1980 upon rail transportation. We of course concur in the statement submitted by Mr. Dempsey on behalf of the Association of American Railroads.

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[12] The carriers contended in *Acco* that the rate proposal was a reduction over which the ICC could not exercise maximum rate jurisdiction. They also claimed that, as a reduction, the rate was subject only to minimum, not maximum, rate standards. They lost on this issue in *Acco*. The combined effect of Dockets No. 37517 and Ex Parte No. 398 apparently might also result in the opposite decision on this issue in future cases, thereby eliminating important substantive shipper rights. This combined effect has escaped public recognition. It may even have escaped recognition by the ICC and been unintended in proposing these rules.

I. PROFILE OF SOUTHERN PACIFIC TRANSPORTATION CO.

A brief profile of SPTCo will help set the framework for my remarks. SPTCo and subsidiaries operate over 14,000 miles of main track serving fourteen Pacific, Southwestern, and Midwestern states. To serve that widespread georgraphical area required a net investment in 1982 of over $3.7 billion and capital expenditures of $143.8 million. Operating revenues were $2.3 billion. Even with our best efforts to control costs and to aggressively compete in the market, the impact of the recession upon some of our major commodities caused a loss from operations of $51.9 million. Our enhanced ability to compete and the reduced burdens of regulation brought about by the Staggers Act were absolutely vital to the level of performance we did achieve in 1982.

Southern Pacific is not one of the principal carriers of coal or grain, although our volumes of those commodities are increasing. Coal constituted 41 percent of the tonnage hauled by the industry, but only 8 percent of SPTCo's tonnage in 1982. Grain products consituted approximately 10 percent of the industry's tonnage, but only 6 percent of Southern Pacific's total tonnage.

Lighter loading manufactured or processed commodities have generally been the mainstay of Southern Pacific's commodity transportation base. For example, movements of processed food products and miscellaneous manufactured goods have each respectively accounted for 14 percent of SP's revenues in 1982. These commodities (along with chemicals) contributed the most revenues to Southern Pacific last year. Lumber also provided 10 percent and autos and auto parts represented 9 percent of Southern Pacific's total revenues.

It is important to recognize that the Staggers Act has been just as important to a carrier whose traffic is primarily one of "non-bulk" commodities as to carriers with other consists. These commodities move in intensively competitive markets where intramodal, intermodal, geographic and product competition provide effective limits on the rail price structure. They are markets in which the burdens of regulation formerly applicable substantially inhibited the ability of the railroad to respond to rapidly changing market conditions. Without the ability to change rates promptly, to enter into contracts, to recover cost increases without regulatory time lags, to eliminate unneeded plant and to take the other steps made possible by the Staggers Act, Southern Pacific would have faced even more difficult problems in this past recession. Southern Pacific and the rest of the railroad industry can now innovate by offering new prices and services to the shipping public, adapt to the rapidly changing market conditions, and take prudent risks that place us more in line with what other industries can and are expected to do. The railroad industry is now a dynamic industry, operating in a customer-oriented manner and driven by customer needs rather than primarily by the burdens and constraints of regulation.

The easing of regulation made possible by the Staggers Act has yet to be fully implemented. The reforms that have been made available by the Interstate Commerce Commission and by the industry have yet to be fully tested. The railroads are in the course of becoming a far more efficient industry, one better able to weather recessions, better able to meet intensive competition, and better able to serve essential customer requirements. Those goals will never come to pass if the clock is turned back and an era of regulatory restraints and slow-moving responses to market changes are reinstated The nostalgia of some interests for that environment is certainly no reason to reverse the course set by the Staggers Act.

The recession has forced the pace of change to be accelerated. It has driven prices downward in many instances and provided stark evidence of the workings of the marketplace. Southern Pacific has responded, for example, by reducing TOFC and many other prices. Its ability to weather the storm was improved by the rate flexibility provided by the Staggers Act in tailoring rates to fit the constraints of the marketplace. Many of the shippers I have talked to over the past few months have candidly recognized that if the railroads had not had the flexibility to adjust prices and services in the declining economy, the railroad industry could well have found itself in much more serious financial consequences. The adjustments in prices and services made by the railroads in a less regulated climate proved to be beneficial for the railroads, shippers and the general public by helping to keep the economy going. It is evident from Southern Pacific's financial results that it has been put to the test in handling the problems of the recession. What is also made evident is that a railroad can no longer take on itself the problems of other industries as a consequence of depressed rates dictated by regulation and not the marketplace.

It is not feasible to cover all the reforms that have benefitted SPTCo and the nation but I will deal with four: contracts, exemptions, recovery of cost increases, and a more efficient route structure.

II. SHIPPERS AND RAILROADS HAVE ACHIEVED A MAJOR BREAKTHROUGH AS A RESULT OF THE ABILITY TO ENTER INTO CONTRACTS

The contract provisions allow railroads to enter into contracts with purchasers of rail transportation services. Once approved by the ICC, these contracts are subject to the jurisdiction of the courts under the terms of the contract rather than to the ICC under the terms of the Interstate Commerce Act. SPTCo is now able to negotiate contract prices and conditions which meet the specific needs of individual customers, and we may commit portions of our plant and equipment to contract movements without fear of regulatory delay and uncertainty once the ICC has approved the contract.

These contract provisions have been widely utilized by shippers and carriers and are becoming a major factor in rail transportation. Over 8,000 contracts have been filed to date with the Interstate Commerce Commission. Southern Pacific has entered into and filed almost 1,200 of these contracts. The wide range of price and service considerations which have been found in rail contracts have included matters such as: guaranteed transit times; guaranteed car supply; payments to the shipper for better freight car utilization; guaranteed train service; price escalation; storage charges; volume guarantees in exchange for purchase and installation of special railroad equipment; long-term annual shipping requirements with financial assistance provided by shippers to rehabilitate rail lines; and, lastly, price discounts or "allowances."

For example, Southern Pacific has entered into contracts with a number of shippers in which service reliability, rather than speed, is the goal. In one instance, service contracts between Portland, Oregon, and Los Angeles, California, call for Southern Pacific to provide four-day service. Since that program has begun, business has improved and reliability has gone from about 60 percent to 85 percent.

The sheer volume of contract filings with the Interstate Commerce Commission is clear evidence by itself of the acceptance by shippers and railroads alike of this new commercial "contract" relationship. Southern Pacific derived approximately $690 million or 30 percent of its total revenues for 1982 from contract transportation, and it is anticipated that these figures will increase as even more shippers become aware of the benefits that the contracts can offer. Competitive prices and services can be tailored through a contract to meet specific shipper needs.

One matter that deserves special mention is the laudable emphasis that the Commission has placed upon facilitating the contracting process. Through its contract regulations published in Ex Parte No. 387, Rail Transportation Contracts, the ICC provided for a relatively streamlined filing process which, in our opinion, insures that all statutory requirements for Commission approval are met while at the same time preserving the flexibility and confidentiality of the contract.

If rail transportation contracts are to remain an effective competitive tool in the rail industry, they must continue to be treated, to the maximum extent possible, in the same manner as contracts in any other industry. The parties must retain the flexibility to accommodate specific needs in the contract document and the parties must also remain assured of confidentiality to insure that the competitive benefits contemplated from the contract are realized.

Contracts permit both the shipper and SPTCo to achieve new levels of efficiency by planning their operations over a future period. In some instances, they provide a solid base for financial investments by both the railroad and the shipper. Prices and service no longer need be based on averages for a total market but can be tailored to individual shipper needs. Contracts have achieved a major breakthrough for both shippers and railroads by permitting both parties to be more competitive.

III. EXEMPTIONS GRANTED BY THE ICC HAVE BEEN ESSENTIAL TO SPTCO'S ABILITY TO EFFECTIVELY COMPETE IN DESIGNATED TRANSPORTATION MARKETS

The ICC has granted exemptions from economic regulation for the transportation of fresh fruits and vegetables, trailer- and container-on-flatcar traffic, boxcar traffic, and a number of other commodities of significance to SPTCo. These moves toward complete economic deregulation were initiated or supported by SPTCo and are being or will be implemented as soon as available. They have proven to be of vital importance to the ability of SPTCo to effectively compete in three rapidly changing transportation markets.

In 1979, at Southern Pacific's request, the Interstate Commerce Commission first experimented with exempting the rail transportation of fresh fruits and vegetables from economic regulation. Rail transportation of these commodities had declined precipitously over the prior three decades to the point where the railroads had a minimal market share. Unregulated truck competition had captured the largest part of the traffic and still provides intensive competition. However, since SPTCo has been allowed to compete in the marketplace under the exemption, shipments of fresh fruit and vegatables have increased each year, rail revenues have consistently increased, rail market share has increased, rail service has improved, and rail prices have remained competitive. In short, the exemption concept has proven to be a clear success for our customers, the consuming public, and SPTCo.

The Staggers Act expanded the Commission's authority to exempt transportation, and it promptly exempted trailer-on-flatcar and container-on-flatcar transportation. In 1980, rail carrier trailer and container loadings on railcars in the United States were down 8 percent from 1979 levels and rail TOFC/COFC business continued to decline into early 1981. By March 23, 1981, when the TOFC/COFC exemption became effective, the rail industry was faced with not only this downward trend in piggyback transportation but also with a stagnant economy which provided little hope of reversing that trend. Furthermore, past experience had shown that when the economy turned down, piggyback traffic volumes declined as much if not more than other rail or motor carrier traffic volumes.

By the end of 1981 (after less than one full year of piggyback deregulation) motor carrier traffic volume showed essentially no change, and rail carloadings were down approximately 3 percent. However, TOFC/COFC loadings had increased by approximately 2.7 percent nationwide, and by 16 percent on SPTCo. Not only did the rail carriers record piggyback gains, but they accomplished this during economic conditions which remained essentially flat.

This trend continued in 1982 as intermodal loadings increased by another 3 percent while total freight car loadings decreased by 12.2 percent. On Southern Pacific alone, intermodal loadings increased by 24 percent and intermodal revenues arose to $338 million accounting for almost 15 percent of SP's total freight revenue. Southern Pacific believes that this growth in piggyback transportation will continue through 1983 and beyond for the same reasons that railroad piggyback performance has been so successful to date.

The industry's performance was based upon a number of factors. First, SPTCo and the rail carriers committed time and resources to capital improvements, research, and improve piggyback operations. They also committed themselves to provide reliable train service. And lastly, SPTCo and the railroads developed marketing and pricing expertise to operate in a competitive market environment. The speed by which railroads could respond to market demands was clearly the result of the exemption. The ability to offer price and service packages which gained business while at the same time insuring for the shipper competitive prices, price stability and the opportunity to better budget resources would not have been available if regulation were still applicable. Furthermore, and perhaps most importantly, without regulation, carriers are responsible for their own destiny and are willing to make commitments of capital, time, manpower, research and service knowing that they can remain relatively assured that the gains achieved through these efforts will not be nullified by prospective regulatory action.

The Commission has recently taken action to exempt boxcar traffic. SPTCo supported the move to eliminate rate regulation of this traffic. The decision has not yet become effective and therefore no experience can be reported. SPTCo is making preparations to implement the decision and will lend every effort to achieve greater utilization of this type of equipment.

The steps to exempt the foregoing and other transportation were taken in recognition of the fact that market forces are pervasive in these areas and that day-by-day responses are needed to keep up with the fast pace of change. SPTCo and the railroad industry have moved aggressively to adapt to the new environment, which has proven to be beneficial to both the shippers and the nation.

IV. QUARTERLY RECOVERY OF COSTS INCREASES UNDER STAGGERS ACT PROCEDURES HAS PROVEN TO BE ABSOLUTELY VITAL

Although inflationary cost increases have not presented the severe problem for SPTCo and the industry in late 1982 and 1983 that had been characteristic of earlier periods, they were a major continuing problem in 1980 and 1981. The limited earnings of SPTCo in the post World War II years make it absolutely vital that such inflationary cost increases as may occur in the future be recovered promptly. Such increases in prices that are actually implemented will of course always be tailored to market conditions.

A key provision in the Act of significant importance to SPTCo and the rail industry gave the railroads the ability to rapidly recover inflationary cost increases. The impact of unrecovered inflationary cost increases upon a revenue inadequate rail industry prior to the Staggers Act was enormous. Just over the five years preceding passage of the Staggers Act, the railroads had to absorb $6 billion in cost increases because of regulatory time lag in obtaining rate increases at both the Federal and State levels.

The Act's indexing system permits accurate and expeditious measurement of rail cost increases. It has placed all intrastate rates under the same inflationary cost recovery procedures. The quarterly estimates of the railroads are reviewed and approved by the ICC and are subsequently audited by the ICC and an outside auditing firm. The credibility of the system has been established, it works, and it has eliminated the time lag.

At a critical point in their history in 1980 and 1981, this procedure proved to be one of the truly significant benefits of the Act to SPTCo and the railroad industry. It is important that it continue to be available for such future inflationary problems as may confront us. SPTCo and a major portion of the industry have concluded that this benefit is of such vital importance to the industry that they have requested the ICC to make such findings as are necessary under Section 219 of the Staggers Act to continue the availability of existing procedures for a period of three years.

V. SPTCO HAS BEEN COMPELLED BY MARKET FORCES TO OPERATE MORE EFFICIENTLY, INCLUDING THE IMPLEMENTATION OF A MORE RATIONAL ROUTE STRUCTURE

The advent of more rigorous competition by all modes has required SPTCo to seek out every possible means of improving efficiency in providing service to the shippers. This has meant a reevaluation of the era of wide open routing, when many routes involving multiple carriers, numerous interchanges, a high volume of blocking and switching, circuity, extended delays in delivery and inefficient use of equipment were often the rule. As competition has worked to produce its inevitable downward pressure on price levels, it has become necessary for SPTCo to take every step possible to improve contribution above variable costs from the traffic it handled. Open routing became a luxury that could not longer be supported.

Restrictions on routes are designed to produce more cost effective and fuel efficient routes. At the same time, SPTCo's program was designed to insure that shippers retained reasonable transportation alternatives via competitive routes and services. Of course, competition by other modes and competition by TOFC service continues unabated and in fact even more stringently in this recession.

The Staggers Act was intended to foster efficient for-profit transportation and competition. SPTCo has endeavored to put in place rail service that fits both of those objectives.

VI. CONCLUSION

The Staggers Act has been helpful to SPTCo in meeting the problems of difficult recession period. It has given us the opportunity to improve our service to the public at the same time we strengthen our financial position as the business cycle improves. Moreover, in my talks with many shippers, I have found a substantial level of approval of the Staggers Act. Those concerns that are expressed relate primarily to possible future developments such as car supply and prices in a recovering economy. SPTCo has been acutely aware of the need to be customer-oriented in this competitive market and will be working closely with shippers to meet any future problems that may arise. The Staggers Act is in the middle of the period of implementation. It is premature to alter its terms before the Interstate Commerce Commission, the railroad industry, and the shippers have tried and tested the provisions of the Act. Some sections of the Act have not been fully implemented, others are in litigation, and some are being worked out in the marketplace. This is not the time to launch a revision to this legislation.

STATEMENT OF W. R. MILLER ON BEHALF OF THE EASTERN COAL TRANSPORTATION CONFERENCE

Mr. Chairman and members of the Subcommittee. My name is W. R. Miller, and I am the Chairman of the Eastern Coal Transportation Conference. ECTC is an association of twenty-two small to medium-sized coal producers and owners of coal producing properties located east of the Mississippi River. it is the successor to the Property Owners' Committee, an organization which was founded in 1926. A list of ECTC's members is attached to my statement as Appendix I.

Because a coal producer's ability to market its product successfully is directly related to the costs its customers must pay to transport it, coal producers such as

ECTC's members have a vested interest in preserving reasonable Eastern coal transportation rates. As a result, ECTC has actively participated in a number of administrative proceedings before the Interstate Commerce Commission involviing matters relating to coal transportation, and has been a party to a number of proceedings in the federal courts to review the Commission's decisions in these proceedings.

ECTC agrees in principle with the theory espoused by Congress in the Staggers Rail Act of 1980: where effective transportation competition is firmly in place, regulation of railroad rates and service practices by the ICC is unnecessary and, indeed, undesirable. In the absence of effective competition, however, action by the ICC to restrian monopolistic carrier rates and service practices is absolutely essential. The purpose of my testimony is to provide the Subcommittee and Congress with the benefit of the views of smaller Eastern coal producers with regard to various actions of the ICC over the past three years through which the Commission has implemented and administered the Staggers Rail Act. It is, unfortunately, our conclusion that at least with regard to coal—a commodity which is a virtual prisoner of the railroad industry—the ICC has totally failed in its mission to protect producers and shippers from abuse of the railroads' monopoly power.

In many instances, the ICC has ignored or acted contrary to the directives of the Staggers Act, to the direct harm of coal producers and the shipping public they serve. Specific, major areas of ICC mismanagement should be of primary importance to the Congress and this Committee in formulating corrective action. They are:

(1) standards for determining railroad revenue adequacy;
(2) coal rate guidelines;
(3) exercise of the ICC's exemption authority;
(4) market dominance; and
(5) calculation of the railroad cost recovery index.

Congress is well aware of the problems captive coal receivers face. Because of the close interrelationship between shipper and producer, the transportation situation faced by coal receivers is shared by producers as well. One of the primary purposes behind the Staggers Act was to balance the necessity of protecting captive coal from monopoly pricing with the railroads' interest in greater pricing freedom where they compete with other forms of transportation. The ICC, however, has embarked on a course which unduly burdens captive coal shippers, and seems to have as its only goal increasing the profitability of the nation's railroads.

1. REVENUE ADEQUACY STANDARDS

a. The ICC's policy

Section 205 of the Railroad Revitalization and Regulatory Reform Act of 1976 ("4-R Act") required the ICC to promulgate standards and procedures for determining rail carrier revenue adequacy through the rulemaking process. The decision resulting from this rulemaking established a standard requiring that ICC to consider "all pertinent financial indicators" in deciding whether a rail carrier was revenue adequate.[1] Under this standard the ICC determined that thirteen of the nation's thirty-six Class I railroads were revenue adequte.[2]

The ICC used its determinations of revenue adequacy chiefly in complaint cases involving captive coal receivers, in which the ICC concluded that revenue inadequate carreirs were entitled to higher rates. The railroads were unsatisfied by this, however, and tried to convince the ICC to promise carrier revenue adequacy solely on a single standard: whether a carrier was earning a current cost of capital return on its net investment base. Further, the railroads argued that a revenue inadequate carrier should be allowed to charge any rate it chose on captive traffic. The ICC flatly rejected the railroads' arguments.

Snubbed by the ICC, the railroads sought Congressional legislation to overturn the ICC's decision. Congress, in the Staggers Act, refused the railroads' requests to modify the revenue adequacy definition of the Interstate Commerce Act. Congress did, however, codify the ICC's practice of considering a carrier's revenue adequacy in reasonableness determinations and rate suspension investigations. Revenue adequacy was also the predicate for deciding whether a carrier was entitled to the use of certain rate flexibility procedures introduced by the Staggers Act. The Staggers Act directed the ICC to make a carrier revenue adequacy determination within 180 days and thereafter on an annual basis.

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[1] Ex Parte No. 338, Standards and Procedures for the Establishment of Adequate Revenue Levels, 358 I.C.C. 844, modified, 359 I.C.C. 270 (1978).

[2] Ex Parte No. 353, Adequacy of Railroad Revenue (1978 Determination), 362 I.C.C. 198 (1979).

The ICC responded to the command of the Staggers Act by instituting Ex Parte No. 393, Standards for Railroad Revenue Adequacy ("Ex Parte 393"). The final order in Ex Parte 393 replaced the previously used revenue adequacy standards with the same rate base/rate of return standard that both the ICC and the Congress had rejected in the past. Ex Parte 393 holds that a carrier is revenue adequate only if it earns a rate of return on its net investment base equal to the current cost of capital for the railroad industry as a whole.[3] No other indicia of financial health—regardless of relevance or reliability—are employed.

Under the Ex Parte 393 standard, not one major railroad in the nation is revenue adequate. In fact, an abyss exists between the railroads' present earnings and those deemed necessary to achieve revenue adequacy under the new standard. Ex Parte 393 also contains three methodological errors that improperly increase the sums that carriers need to be revenue adequate. First, under Ex Parte 393 carrier debt costs are calculated at the current cost of capital, in spite of the fact that much carrier debt was issued many years ago at interest rates far below those presently charged. Second, the ICC determined to allow deferred taxes to be included in the net investment base, though such monies, contributed to the carriers by ratepayers, is no-cost capital which clearly should be excluded if one is focusing on the amount of money a carrier needs to pay its expenses, debt service, and attract captial. Third, unused and nonuseful assets may be included in net investment bases under the ICC decision. By the carriers' own figures in Ex Parte 393, shippers are paying a rate of return on at least a quarter billion dollars' worth of property that the carriers do not use. Needless to say, these three errors vastly inflate the amount railroads need to reach the magic plateau of "revenue adequacy."

The ICC has also elevated revenue adequacy to be the sole factor it considers in determining the reasonableness of rates on captive coal traffic, in direct violation of Congress' intent. Congress mandated a balance of "the needs of carriers, shippers and the public" in setting coal rates. At present, for all practical purposes the ICC permits carriers to charge whatever rates they choose on coal traffic so long as the rates contribute to the goal of revenue adequacy,[4] and as a result has de facto deregulated coal rates to captive receivers. This is plainly not consistent with the balance Congress sought in enacting the Staggers Act.

b. The railroads are financially healthy

The ICC's contention that no major rail carrier is revenue adequate is shown to be particularly unrealistic when one examines the evaluations of the carriers' financial health provided by the financial press. Such articles refer, for example, to large amounts (in each case over a billion dollars) that Burlington Northern, CSX and Norfolk Southern have amassed for corporate acquisitions,[5] and contain glowing recommendations of the railroads' stocks to potential investors.[6] While the railroads often point to these reports as misleading—they say the reports refer to their holding companies—the fact is that in each case the holding company in question derives the lion's share of its capital from rail operations. The nation's coal hauling railroads, though not revenue adequate within the ICC definition, are healthy enough to make major corporate acquisitions at will and to be recommended as attractive investment posibilities. Something is clearly amiss.

In spite of the obvious gap between the ICC's view of revenue adequacy and reality, the ICC has shown no signs of changing its revenue adequacy standards. Congress must act to reaffirm its position that revenue adequacy determinations should be based on all relevant financial indicators, that ICC revenue adequacy determinations be more realistic, and that revenue adequacy be but one consideration in maximum rate determinations.

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[3] Ex Parte 393, Standards for Revenue Adequacy, 364 ICC 803 (1981).

[4] See, e.g., No. 38793, Petition For Review of a Decision of the Public Service Commission of West Virginia Pursuant to 49 U.S.C. 11501 (Decision served March 13, 1982), appeal docketed sub nom. Wheeling-Pittsburgh Steel Corp. v. United States, No. 82-3122 (3rd Cir. March 25, 1982); No. 38946, Petition of the Louisville and Nashville Railroad Company For Review of a Decision of the Public Service Commission of Indiana Pursuant to 49 U.S.C. 11501 (Decision served June 23, 1983), appeal docketed sub nom. Public Service Commission of Indiana, Inc. v. ICC, No. 83-1691 (D.C. Cir. June 24, 1983).

[5] See Business Week, March 8, 1982; Wall Street Journal, July 1, 1983; and Forbes, April 12, 1982.

[6] See Trendline's Current Market Perspectives, April, 1983, p. 44; Value Line, April 8, 1983, p. 304; and Value Line, May 20, 1983, p. 1232.

2. COAL-RATE GUIDELINES

ICC policy on maximum reasonable rates for captive coal traffic—traffic which has no alternative to rail service for transportation—is one of the most critical issues facing this Subcommittee and the entire Congress. Under the ICC's present standards, coal shippers and receivers are left completely unprotected from the monopoly pricing practices of the railroads which control volume coal transportation.

a. The search for a formula

Before the Staggers Act, the ICC depended primarily on three criteria in evaluating maximum rate reasonableness: comparisions of the challenged rate with existing rates for comparable movements; the relationship between the rate and the service costs associated with the movement; and the public interest. After several years of gradually increasing its reliance on the cost-of-service standard, in 1979 the ICC settled on a cost-based formula known as the "seven percent solution."

The seven percent solution allowed carriers to recover fully allocated costs at the revenue need level, as well as a seven percent additive or cross-subsidy awarded to promote railroad revenue adequacy. The railroads argued that since they were forced by competition to charge less than their fully allocated costs on some movements, they must be allowed to charge more than fully allocated costs on captive traffic in order to earn an average return at the required revenue level. The ICC agreed, though it cautioned that railroads were not to look solely to captive coal traffic for recovery of their revenue needs.

The ICC adopted the seven percent solution as an interim approach pending a decision in Ex Parte No. 347, Western Coal Investigation, a proceeding designed to establish principles for determining reasonable rates on western unit-train coal traffic.[7] The ICC's "interim" approach was struck down by the U.S. Court of Appeals for the D.C. Circuit, however,[8] on grounds that the ICC's decision "provide[d] no defensible rationale for the inclusion of the seven percent additive" and was therefore arbitrary and capricious. The Court did not rule out any increment over full costs, but stated that the ICC had to adequately justify such an increment. At the time the Staggers Act was enacted, the ICC's efforts to develop a comprehensive coal rate methodology floated in a state of suspended animation.

The Staggers Act retained the pre-existing standard for rail rates on market dominant traffic: i.e., that all such rates be "reasonable." Congress was especially concerned, however, over the fate of captive shippers—particularly coal shippers. The legislative history of the Staggers Act is replete with references to the need to place effective constraints on captive coal rates.[9]

The Staggers Act also inserted provisions into the law itself designed to safeguard against rail cross-subsidization and supra-competitive pricing at the expense of coal traffic. The "Long-Cannon Amendments" [10] are an attempt to balance protection for captive shippers with the flexibility given railroads in pricing market dominant traffic. The Amendments make clear that captive traffic cannot be forced to bear a disproportionate burden of the costs of carrier revenue adequacy.

Shortly after the Staggers Act was enacted, the ICC proposed new maximum rate guidelines for coal transportation in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines—Nationwide. These guidelines proposed a formula based on the variable cost of service, a share of fixed costs determined on the ton/ton-mile method of allocation, and a return on investment equal to the current cost of capital. The railroad responded to this formula by proposing that the ICC permit them to price their traffic as they see fit until they reach revenue adequacy. In effect, they advocated that they be allowed to charge "what the traffic will bear." In December, 1981, the ICC rejected the guidelines it had proposed in Ex Parte No. 347 (Sub-No. 1) and requested further comments on the type of standard it should adopt, and between December, 1981 and Feburary, 1983 there was an unofficial moratorium on ICC decisionmaking on maximum rates for coal traffic.

b. Open season on captive coal

On February 24, 1983 the ICC proposed an entirely new methodology for evaluating captive coal rates. The new formula is being sold by the ICC as a "matrix," under which any captive coal rate (or increase) by a revenue inadequate carrier would be deemed reasonable, unless it ran afoul of one or more of the following constraints:

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[7] 43 Fed. Reg. 22151 (May 23, 1978).

[8] *San Antonio, Texas* v. *United States*, 631 F.2d 831, 851 (D.C. Cir. 1980).

[9] See, e.g., S. Rep. No. 96-470, 96th Cong. 1st sess. 7, 8 (1979); H.R. Rep. No. 96-1430, 96th Cong. 2d sess. 80 (1980).

[10] See 49 U.S.C. § 10707a(e)(2)(C).

(1) a rate may not exceed the "stand-alone" costs of service associated with the movement;

(2) a rate may not impose on a shipper avoidable costs arising from management inefficiencies;

(3) a rate may not be raised by more tha 15 percent per year (after inflation); and

(4) once a carrier achieves revenue adequacy within the ICC definition, its ratemaking flexibility would be subject to tighter constraint.

The new methodology, which the Commission has already stated will apply in all pending cases, may well prove to be disastrous to the struggle for balanced rail rate regulation and the protection of captive coal shippers and producers. The constraints the ICC proposes are not constraints at all.

The stand-alone "constraint" effectively caps rates at a level equal to the shipper's cost of acquiring and operating its own rail line. In one recent case,[11] a rail carrier has calculated that the "stand-alone" cap on its movement to an Eastern utility would allow rates of approximately $182.00 per ton, about 1,400 percent higher than the current rate.

The "managerial inefficiency" constraint is without teeth. The ICC has enunciated no standard for measuring efficiency, nor does it possess a proper data base. It is claimed by the ICC that this constraint incorporates the Long-Cannon Amendment into ratemaking, but the Commission has shown no intention of requiring carriers to divulge the information necessary to address managerial efficiency—information they alone possess.

The third "constraint" allows any rate to increase by 15 percent per year, after inflation. In so doing the ICC has almost tripled the 6 percent figure set by Congress (49 U.S.C. § 10707a(c)) as the upper limit of rate flexibility available to rail carriers without fear of ICC scrutiny. According to the ICC, 15 percent per year increases on coal traffic alone will ensure that the rail industry achieves revenue adequacy within 7 to 9 years—the time the ICC predicts that coal slurry pipelines will be available. In blatant disregard of Congressional intent, the ICC is encouraging railroads to look to a single captive commodity to recover their entire alleged revenue shortfall.

The fourth constraint is meaningless at this time, because the ICC has given no indicaton of how its rate evaluation would change once a carrier became revenue adequate.

In sharp contrast to the zeal with which the ICC pursues increased rate flexibility in the name of railroad revenue adequacy, the Long-Cannon criteria—enacted out of Congressional concern for captive coal shippers—have been virtually ignored in the 33 months since their passage. The Long-Cannon criteria require consideration of the amount of non-compensatory traffic hauled by a carrier, the extent to which a carrier maximizes its marginal traffic revenues, the mix of a carrier's traffic, and whether particular segments of traffic are required to pay an unreasonable share of overall revenues, in assessing the reasonableness of a carrier's rates.

The ICC has effectively robbed the Long-Cannon criteria of any meaning by placing the burden of presenting evidence relative to the criteria on shippers, while refusing to require railroads to divulge the information necessary to address the criteria. Gutting the Long-Cannon criteria has rendered nugatory the Congressional effort to balance carrier rate freedom with captive shipper protection.

3. ICC EXERCISE OF EXEMPTION AUTHORITY

Of all the example of the ICC's administrative emasculation of the protections for captive coal shippers and producers intended by Congress in the Staggers Act, perhaps the most disastrous from the perspective of the small Eastern coal producer took place in March of this year, when the ICC announced its decision to remove all aspects of ICC regulation from the inland transportation of export coal by rail. This far-reaching action, taken in Ex Parte No. 346 (Sub-No., 7) Exemption From Regulation—Export Coal, eliminated all ICC jurisdiction over pricing practices, common carrier obligations, and non-discriminatory practice questions related to the transportation of coal exports.

Under the Staggers Act, the ICC is empowered to grant exemptions from regulation only when it finds that an exemption would be consistent with national transportation policy and (1) would be limited in scope or (2) would not expose shippers to abuse of rail market power. In the case of export coal, the Commission purported to find that continued regulation was not necessary to protect coal producers and shippers from rail market power abuse, notwithstanding the undisputed fact that over 90 percent of the mines producing coal for export are wholly captive to a single rail line for access to essential export terminal facilities.

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[11] Docket No. 37872, *Potomac Electric Power Co.* v. *Baltimore & Ohio Railroad Co. et al.*

The ability of a party to protect itself from abuse of market power in the absence of regulation depends wholly on the relative market strength of that party vis-a-vis those with whom it does business. Large shippers of coal producers whose facilities are served by more than one railroad are few; the vast majority of export coal producers are small to medium-sized companies, and many are concentrated in the Eastern Appalachian coal fields. Because of their small size, these producers have virtually no leverage in dealing with the two railroads (CSX and Norfolk Southern) which together dominate the export coal transportation market. Under the ICC's exemption, these carriers will be free to dictate any rates they choose to export coal shippers. They will be under no obligation to restrain from imposing discriminatory rates on those shipments moving to river points for further transportaiton by barge, and in those instances where a particular coal producer's traffic does not offer an attractive enough revenue picture the carrier will be free to refuse to provide service altogether. Additionally, by removing export coal from the prohibitions of the so-called commodities clause, the ICC's decision will enable Eastern rail carriers to mine coals from their own properties, transport it over their own rail lines, tranship it through their own coal export terminals, and—if recent news reports are to be believed—load it onto their own ocean vessels. Such vertical integration could clearly mean the end of the small producer's participation in the export coal trade. The result (aside from increased rail profits) would be increased unemployment, an acceleration in small business failures, an anti-competitive concentration of market power in the hands of a few large producers, and a steady decline in America's position as a supplier of quality steam and metallurgical coal.

Through its decision in Ex Parte 346 (Sub-No. 7), the ICC has administratively deregulated the quintessential captive commodity—coal—in direct contravention of Congressional intent.

4. MARKET DOMINANCE

The concept of market dominance was established in Section 202 of the 4-R Act. Under the Act, "market dominance" was defined as: "an absence of effective competition from other carriers of modes of transportation, for the traffic or movement to which a rate applies." The 4-R Act required that the ICC promulgate, by rule, standards and procedures that would facilitate practical determinations of market dominance.[12]

Congress adopted the market dominance test, as explained in the Conference Report, "to permit rates to be set by the forces of competition in those situations in which effective competition exists."[13] In addition, the history of the 4-R Act indicates that Congress intended that the ICC's market dominance rules "be designed to provide for a practical determination without administrative delay." On October 1, 1976, the ICC issued its decision in Ex Parte No. 320, Special Procedures For Making Findings of Market Dominance As Required by the Railroad Revitalization and Regulatory Reform Act of 1976,[14] and promulgated the rules required by the 4-R Act. Under the rules, a finding of market dominance could be triggered by a shipper's showing that the circumstances surrounding its transportation arrangements fit one or more "presumptions" (e.g., rate/cost ratio, market share, shipper investment in carrier equipment).

The ICC also established specific procedures for considering issues of market dominance.[15] Finally, the ICC reaffirmed its earlier finding that the statutory definition of market dominance and Congress' intent regarding application of the concept limited the scope of consideration to direct transportation competition for the traffic or movement in question.[16]

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[11] Pub. L. No. 94-210, § 202(b) 90 Stat. 31 (1976).

[12] S. Rep. No. 94-595, 94th Cong. 2d sess. 148 (1976).

[14] 355 I.C.C. 12 (1976).

[15] These procedures set forth in specific and mandatory terms the evidence which parties were to present, the form such evidence should take and where it was to be presented. See 355 I.C.C. at 22-23.

[16] The Commission's Final Order in Ex Parte No. 320 was upheld by the U.S. Court of Appeals for the District of Columbia Circuit in *Atchison, Topeka & Santa Fe Railway Co.* v. *ICC*, 580 F.2d 623 (D.C. Cir. 1978).

Since passage of the Staggers Act, the Commission has scrapped its prior market dominance rules and substituted a long list of "evidentiary criteria," which it calls "guidelines for submitting evidence." These guidelines were developed in Ex Parte No. 320 (Sub-No. 2), and were allegedly based upon the "intent" of the Staggers Act, although the Staggers Act specifically left the definition of market dominance unchanged. The guidelines (which are in effect today) are divided into four categories: intramodal competition, intermodal competition, geographic competition, and product competition. Thirty criteria are listed under these four headings. Simultaneously with its order in Ex Parte No. 320 (Sub-No. 2), the ICC issued an order in Ex Parte No. 320 revoking the existing market dominance regulations—a radical repudiation of the procedures developed under the 4-R Act.

The Commission's current position on geographic and product competition is inconsistent with the statutory directive that the market dominance standard be a practical, threshold test. The ICC itself recognized that: "determining whether [geographic and product competition] have a significant impact in a particular case would require anti-trust type litigation, as the interplay which affects competition for the sale of a product and competition for transportation services is very complex." Ex Parte No. 320, 353 I.C.C. at 905.

The manifest purpose of the market dominance concept was to facilitate an early determination of the existence of competition for the traffic that is subject to a challenged rate—and thereby determine ICC jurisdiction over that rate. The ICC's authority to promulgate rules was an integral part of Section 202 of the 4-R Act, and was counted upon to guard against protracted, complex market dominance proceedings.

There is no doubt that the Ex Parte No. 320 rules and procedures achieved the result contemplated by the 4-R Act. This was recognized by the D.C. Circuit in *Atchison, T. & S.F. Ry. Co.* v. *U.S.* However, in its decision in Ex Parte No. 320 (Sub-No. 2) the ICC completely abdicated the responsibility placed upon it by Congress in the 4-R Act. Market evaluations by the ICC under its Ex Parte No. 320 (Sub-No. 2) guidelines involve complex issues of antitrust law which the ICC is neither designed nor staffed to resolve, and which Congress never intended to be a part of the market dominance determination.

In a decision issued in December, 1982, a panel of the U.S. Court of Appeals for the Fifth Circuit ruled that the ICC's inclusion of potential geographic and product competition in analyses of carrier market dominance "violates the limits contained in the statutory definition and is invalid." [17] If the panel's decision on these matters is affirmed, Congressional action will still be needed in order to address the ICC's "laundry list" approach to market dominance findings. If the panel's decision is reversed, however, immediate legislative action would be crucial to the preservation of shipper access to the ICC for adjudication of maximum reasonable rate disputes.

5. RAILROAD COST RECOVERY INDEX

Section 203 of the Staggers Act allows carriers to take quarterly freight rate increases according to an index of railroad costs—the rail cost adjustment factor. These increases are totally immune from shipper challenge. The ICC uses an index compiled by the AAR called the "Index of Railroad Material Prices and Wage Rates," an index which measures the prices the railroads pay for purchased materials and wages. It is an index of input prices, unadjusted for changes in productivity and traffic volume. The Index, as a result, overstates the rate increases needed to yield additional revenues sufficient to cover cost increases.

The failure of the ICC's rail cost adjustment methodology to adjust the AAR Index for productivity changes was challenged by shippers immediately after its announcement in Ex Parte No. 290 (Sub-No. 2), Railroad Cost Recovery Procedures.[18] The court affirmed the ICC decision,[19] though it agreed with shippers that in section 203 Congress meant only to allow recovery of costs, not the enhancement of revenue. The Court stressed that it expected the ICC to revise its Index, including consideration of a productivity adjustment, as circumstances might warrant.[20]

The legislative history and language of Section 203, now codified at 49 U.S.C. § 10707a(a)(2)(B) support beyond question the D.C. Circuit's conclusion that the cost recovery index is meant to allow unquestioned rate increases only to neutralize the effects of inflation. The Section itself states, in pertinent part: "Commencing with the fourth quarter of 1980, the Commission shall * * * publish a rail cost adjustment factor * * * with appropriate adjustments to reflect the changing composition of railroad costs, including the quantity and mix of materials and labor. * * *"

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[17] *Western Coal Traffic League* v. *U.S.*, 694 F.2d 378 (5th Cir. 1982) (ECTC participated in this case as amicus curiae).

[18] 364 I.C.C. 841 (1981).

[19] *Western Coal Traffic League* v. *United States*, 677 F.2d 915 (D.C. Cir. 1982).

[20] Id., at 931.

The legislative history also demonstrates that Congress specifically intended the ICC to use output costs (rather than input prices) in the Cost Recovery Index.[21] The ICC's continued use of the unadjusted AAR Index is in blatant disregard of Congress' directive that the cost recovery index be used solely to reduce "the time lag involved in recovering cost increases."[22]

The ICC did begin a proceeding designed to solicit suggestions on the development of certain productivity adjustments to the AAR Index.[23] However, the Commission's progress in this area has been anything but swift. The advanced notice of rulemaking was served one year ago, comments were filed in October, 1982 and yet the ICC has still not proposed a productivity adjustment mechanism. While the ICC may be complying with the letter of the D.C. Circuit's admonition, the spirit of the Court's directive is being ignored. There is no excuse for the ICC's foot-dragging in this area, though it seems nothing short of a mandate from Congress would suffice to prompt the Commission into positive action.

6. A LEGISLATIVE RESPONSE

Two bills, S. 1082 (introduced by Senator Ford) and H.R. 2584 (introduced by Representative Rahall) would address many of the serious problems resulting from the ICC's one-dimensional view of the Staggers Act. In particular, these bills would:

(1) make it clear that railroads have the burden of going forward with evidence responsive to the Long-Cannon criteria, and that although revenue adequacy is an important consideration in maximum rate determinations, the Commission must also take into account a number of other important factors;

(2) ensure that the ICC takes into consideration a variety of widely-utilized indicators of financial health in determining carrier revenue adequacy, and ensure that the railroads' net investment base would not include such no-cost items as deferred taxes and unused or nonuseful assets;

(3) require the ICC to consider changes in railroad productivity in developing its quarterly inflation index;

(4) codify the market share and substantial investment presumptions which were contained in the Commission's pre-Staggers Act market dominance regulations, and preclude the ICC from considering potential geographic and product competition in making market dominance determinations; and

(5) prohibit the ICC from granting an exemption from regulation in connection with captive rail traffic, such as coal and other bulk commodities.

The Eastern Coal Transportation Conference supports H.R. 2584 and S. 1082. As these and other bills which may be introduced dealing with these issues are considered by the Congress, ECTC would also support amendments or new provisions which would deal more definitively with the standards to be applied by the Interstate Commerce Commission in determining maximum rate reasonableness.

EASTERN COAL TRANSPORTATION CONFERENCE

Amherst Industries, Inc., Charleston, W. Va.; ANR Coal Company, Roanoke, Va.; Armco Material Resource, Richmond, Va.; A.T. Massey Coal Company, Richmond, Va.; Berwind Corporation, Philadelphia, Pa.; Blue Diamond Coal Company, Knoxville, Tenn.; Cannelton Industries, Inc., Charleston, W. Va.; Carbon Fuel Sales Company, Charleston, W. Va.; Cyprus Coal Company, Englewood, Colo.; Diamond Shamrock Coal Unit, Lexington, Ky.; Elk River Resources, Knoxville, Tenn.; Inspiration Coal, Inc., Knoxville, Tenn.; Kessler Coals Co., Inc., Charleston, W. Va.; Land Use Corporation, Summersville, W. Va.; Logan & Kanawha Coal Company, Cincinnati, Ohio; Old Ben Coal Company, Chicago, Ill.; Perry & Hylton, Beckley, W. Va.; Pickands Mather & Company, Cleveland, Ohio; Pratt Mining Company, Hansford, W. Va.; Slab Fork Coal Company, Slab Fork, W. Va.; South East Coal Company, Irvine, Ky.

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[21] S. 1946, 96th Cong. 1st sess. at 103 (1979), S. Rep. No. 96-470, 96th Cong., 1st sess. at 52 (1979) ("Senate Report").

[22] Senate Report, at 19.

[23] Ex Parte No. 290 (Sub-No. 4).

STATEMENT OF THE MINING AND RECLAMATION COUNCIL OF AMERICA [MARC]

MARC is a national non-profit trade association of coal operators and ancillary companies whose members and affiliate organizations mined approximately 70 percent of the nation's surface coal production last year. Approximately 70 percent of MARC's members' production was shipped by rail with 85 percent of those movements captive to a single carrier.

Rather than reiterating points made by other witnesses at the hearing, this statement will focus on several key issues of concern to MARC. In doing so, we endorse the major points made in the testimony of the National Coal Association, the Edison Electric Institute, and the Western Coal Traffic League. MARC specifically supports: (1) prompt consideration and enactment of S. 1082, introduced by Senator Ford, and H.R. 2584, introduced by Representative Rahall; and (2) the nomination of individuals for vacant seats on the Commission who demonstrate an impartiality with respect to treatment of carriers, shippers, and the public.

MARC supported enactment of the Staggers Act in 1980 because it balanced the need to provide railroads an adequate return on their operations with protection for captive shippers. In the Act, the Congress, recognizing the transportation monopoly railroads have over captive shippers, provided for review of the reasonableness of rates and established a zone of flexibility for rates to guide the ICC in its administration of the Act. In clear disregard of statutory language and legislative history, the ICC, through a series of administrative actions highlighted in the referenced testimony of other witnesses has virtually eliminated review of rates for captive shipments; jeopardized the fulfillment of the goals and objectives set forth in the Act; and, compromised the public interest.

A recent report by the Energy Information Administration, "Railroad Deregulation: Impact on Coal," underscores our concern that the recent ICC decisions on coal rate guidelines, export exemption, and revenue adequacy, will result in decreased domestic use of coal and reductions in coal exports. Such a result clearly contravenes the national goal of increasing the use of domestic energy supplies and is inconsistent with the actions of the current and previous Administrations to increase the export of American coal. In spite of a reduction in coal transported by rail, the report points out, the railroads would earn greater revenues as a result of rail rate increases. This finding directly contradicts the argument of the railroads that charging unreasonable rates would harm them by reducing the amount of coal shipped by rail.

Smaller coal operators will be particularly disadvantaged by recent ICC actions. They do not have the scale of operations necessary to utilize unit train rates and because their mine or mines are only served by one carrier, they have no economic leverage to negotiate with the railraod. For them, the only economic option available, to not ship coal, is not viable. They must pay the rate dictated by the railroad without any recourse to the ICC for review of the rate's reasonableness. The only negotiating leverage available to captive shippers is the possibility of ICC review.

To assure the fulfillment of Congressional intent in enacting the Staggers Act, it is imperative for legislation as that referenced above to be enacted promptly. The areas requiring action are set forth succintly in the Statement of Position on Necessary Amendments to the Staggers Rail Act of 1980 adopted by the Rail Shippers Coalition. A copy of that position with a listing of supporting organizations follows.

RAIL SHIPPERS COALITION STATEMENT OF POSITION ON NECESSARY AMENDMENTS TO THE STAGGERS RAIL ACT OF 1980

The Staggers Rail Act of 1980 was intended by Congress to reform railroad regulation allowing railroads greater flexibility in setting prices and reducing costs where transportation competition exists while continuing vital protection for captive shippers against abuses in rates and services arising from the exercise of monopoly power by the railroads. The Act also sought to promote rail-to-rail competition.

Clearly, the Interstate Commerce Commission, in implementing the Staggers Rail Act, has ignored the intent of Congress and failed to provide meaningful balanced protection for captive shippers against monopolistic abuses by railroads. For example, the Commission has exempted whole commodity groups from the Act even though many shippers within these groups are captive to one rail carrier. Furthermore, the Commission has allowed several major rail carriers to cancel joint rates and through routes, as well as reciprocal switching agreements, causing the elimination of intramodal rail competition—again in contravention of Congressional intent.

Legislation is necessry to assure that the Interstate Commerce Commission fulfills the balanced twin goals of the 1980 Act of elimination of unnecessary regulation and the continuance of necessary protection to captive shippers.

Among the critical subjects that must be addressed in such legislation are the following: Determination of reasonable rail rates for captive shippers; Determination of railroad revenue adequacy; Determination of railroad market dominance; Prohibition against exemption of market dominant traffic; and Prohibition against anticompetitive rail actions such as cancellation of through routes, joint rates and reciprocal switching agreements.

The legislative amendments must reiterate and implement the legislative purposes that have been misinterpreted, ignored or cavalierly disregarded in the decisions of the Commission since the passage of the Staggers Rail Act.

LIST OF ORAGANIZATIONS SUPPORTING THE STATEMENT

National Association of Manufacturers, Chemical Manufacturers Association, National Coal Association, Edison Electric Institute, National Rural Electric Cooperative Association, American Public Power Association, American Bakers Association, The Fertilizers Institute, Western Fuels Association, Mining and Reclamation Council, and Institute of Scrap Iron and Steel.

STATEMENT OF MONTANA PUBLIC SERVICE COMMISSION

The Montana Public Service Commission appreciates this opportunity to discuss the quality and cost of rail service in Montana. Though the subject is our greatest source of frustration, we continue to consider it a paramount public policy issue in Montana. Hopefully, our experience and viewpoint from the State level will advance development of rail law at the national level where improvement must eventually occur.

We are Montana's counterpart for the ICC, the FCC and FERC. On the utility side of our agency, we regulate nearly 600 water, sewer, telephone, gas and electric monopolies. On the transportation side, we regulate trucking and bus certification, rates and safety as well as garbage service and railroads. Though many improvements are yet to be implemented, we consider ourselves a serious presence for nearly all of our jurisdictional companies to face except the railroads.

In summary, railroad regulation in the public interest in Montana is a shambles. We tangently touch railroading in the areas of rate review, facility abandonment and safety. In the area of rate review, our influence was marginal before the Staggers Act because so little rail traffic in Montana is intrastate. Most either originates or terminates here, but not both. With the advent of the Staggers Act, our marignal situation became laughable. We were expected to acquire the procedural approach of the ICC, which, in a nutshell, "puts very little, if any, burden on the railroad to justify rate changes." Even when we thought we had sufficiently watered down our traditional approach to regulation, we failed to achieve certification. Along with most other states, our Commission is still being held in limbo by the ICC. Attachment 1 is the formal effort by our Commission to set procedural rules into effect.[1] Our attorneys advise us that if we can show some progress, we might curry favor with the ICC. If you have time to read the rules, you might ask if the apple polishing is worth the effort in view of how litle intrastate traffic we have, and how light the regulatory "tough" must become. We have concluded that if a little effort on our part will eventually save some Montana shippers a trip to Washington, D.C., for an otherwise insignificant intrastate rate case, then it is in the public's best interest to get the certification. The whole thing seems like a farce to us and should not lead anyone to the conclusion that serious railroad rate regulation is on-going in our State.

We have been quite busy with facility abandonment requests in the last 18 months. Atachment 2 lists the requests for 1982. Attachment 3 is an example of the "Burlington Formula" which is really the only piece of information we get to use, besides stiff cross-examination and occasional shipper testimony, to affirm or deny the abandonment request. That leaves the Commission in a captive and a passive position to mainly carry out the railroad's corporate goals of getting rid of certain facilities. They decide when to apply (what part of the business cycle for housing or grain), they format the figures (let us see what they want us to see), and then they argue every fine point of the law to demonstrate that the public's convenience and necessity no longer require facility X. Nowhere is there any evidence on the record to show that a quiet depot might be busier if the company had not years earlier requested to get out of the less than carload shipment business, or that the stock facility might be used if the railroad had stock cars or encouraged stock shipment, or that the station agent might be busier if railroad pricing was not such that local farmers can get a 15 cent or 25 cent per bushel break by traveling forty miles to a unit train sub-terminal. All they attempt to show is that business through Facility X has declined for a three year period. The Commission is left to prove otherwise or end up in Court.

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[1] The attachments referred to in this statement have been retained in the committee files.

As it has evolved, we have denied some abandonment based on some sketchy evidence that the public still has need of the facility or agent. We have denied others based upon a rather arbitrary state law that says a depot and agent have to remain in every town with greater than 1,000 population, or every town that is a county seat. Our enforcement of that statute is in court at this time. As well, we have ordered an abandoned depot replaced in the town of Philipsburg for both reasons: a county seat and greater than 1,000 population. In that case the railroad sawed the depot in half and sold it to the local Postmaster without asking our permission. In other cases, we have denied abandonment based upon Indian jurisdictional considerations (Lodge Grass and Browning). To put the matter bluntly, we find ourselves grasping at antiquated straws that will hold up in court in an effort to at least temporarily slow the wholesale destruction of rail service as we know it in Montana.

We have little to say about branchline abandonments. As you know that is an ICC matter. We have watched carefully the early stages of abandonment by the railroad. We witness how they position cars in storage north of Fort Benton, or south of Drummond. Later, they can demonstrate that there has been no traffic over those routes. We did catch them when they embargoed bulk grain cars on the branchline to Valier. Had that been allowed to continue, then the local grain growers would have had no choice but to carry their grain to the closest unit train sub-terminals to take advantage of unit grain prices not available with smaller capacity trains at Valier. We directed a Show Cause Order to Burlington Northern asking why they should not be expected to provide equal service to the residents of Valier until the branchline could be brought up to modern specifications. Ours was essentially a bluff. That, combined with the impressive past shipping volumes from Valier, significant community interest, and support from the Governor's office, paid off. Low interest money was loaned to the railroad for track improvement and the town of Valier will remain viable. Had the matter gone unchallenged at the earlier stage, it would have been unbeatable at the abandonment stage. Examples of the latter category are the Basin to Helena line, Circle to Brockway line, and the Red Lodge line.

The current abandonment laws allow certain eventual abandonment of lines that the railroad finds inconvenient to serve. They simply have to keep the level of operations on the line in question to a minimum long enough, so that, like our Commission with regard to depot abandonment, the ICC will have no choice under present law but to approve.

We are supposed to enforce a few scattered rail safety laws. We haven't been doing it for lack of budget. When it comes time for getting money to fund a rail safety inspector, the Rail lobbyists inevitably appear and advise our Appropriations Subcommittee that the Federal rail inspectors are doing a fine job (even though they thinly spread and there are several state statutes that they don't have to enforce), or that OSHA inspectors are protecting railroad working men (even though the railroad is fiercely fighting to stay beyond OSHA jurisdiction). We have tried to work with FRA inspectors but it has been unsatisfactory. It appears that we may get some financial help from this session to train, equip and pay a Montana inspector that will enforce Federal, State and State worker safety laws. It is still too early to tell if the State 50-50 matching will be forthcoming from this session.

I have included as Attachment 4 a copy of Figure 25-5 out of the basic Samuelson Textbook on Economics. It quite clearly demonstrates the traditional performance of an unregulated monopoly and the purpose of regulation. It appears that the U.S. Congress somehow neglected this fundamental. Note that with an unregulated monopoly, prices are higher per unit and the quantity of service is less. The role of regulation is to increase service and lower unit price to where it might be in a competitive situation. In Attachment 5 I have included some interesting information on the performance of BN in Montana in 1981, but the critical information of whether the railroad is performing as a monopoly or not is missing. Believe me, it is difficult to acquire.

If we presume that the unit of service is ten miles per ton of grain shipped, and the unit of price is dollars per ton mile, we can verify if we are in fact facing a railroad monopoly, currently unregulated, in our State of Montana. Even if total tonnage has gone up, or the gross price may even have gone down (doubtfully), the question should be: Does the railroad carry a ton of grain as far as it would for the price it would otherwise charge under competition? We can't lay our hands on those kinds of figures; you may be able to.

There is much to discuss regarding the principal railroad in Montana. Are their strategic planners really interested in profit maximization for the holding company, or are they interested in long-term profitable transportation services for Montana? Attachment 6 is an interesting presentation of a holding company's situation to its management. In this case, the format is a Harvard Business School case study. I have enclosed one of the better evaluations of the BN's case by an up and coming Harvard Business School student. Reading of this type of material is mandatory to begin an understanding of how an impersonal conglomerate operates. In the absence of interstate regulation in the public interest, expecting the holding company management to protect the public's interest is tragically euphoric.

Finally, we wish to draw your attention to the fact that our Commission is currently engaged in a thorough review of the reorganization of Montana Power as a holding company along the lines of Burlington Northern. We have been in court twice proving our ability to review such a significant reorganization. Fortunately, the courts thus far have upheld us. We are currently in the Supreme Court with final arguments and in the advanced stages of completing our investigation into the dangers and benefits of formation of a holding in which the public utility is but an affiliate of many other profit centers. If you are interested in our thoughts on the matter, we will be glad to keep you apprised of our findings. They should apply to any company chartered to operate in the public interest.

STATEMENT OF DONALD M. MURRAY, ON BEHALF OF THE B. F. GOODRICH CO. (CHEMICAL GROUP)

My name is Donald M. Murray and I am testifying today on behalf of the B. F. Goodrich Company (Chemical Group). My business address is 6100 Oak Tree Blvd., Cleveland, Ohio 44131. I have been employed by the B. F. Goodrich Company for 16 years and am currently the Director of Distribution for the Chemical Group with responsibilities for the worldwide distribution of products and the direction and supervision of 104 people. I hold a Masters of Business Administration degree and a Bachelor of Arts with a major in Transportation. I have been a registered Interstate Commerce Commission Practitioner since 1959.

B. F. Goodrich is a diversified manufacturer of rubber, chemical and plastic products for the aerospace, consumer, construction, energy, environmental control, industrial, mining, petroleum and transportation markets. B. F. Goodrich is also a leading fabricator of engineered metal products and systems for aviation, ground-vehicle and materials-handling use.

The following comments are meant to express my disillusionment with the way in which the Staggers Act has been implemented by both the Interstate Commerce Commission and the railroad industry.

The rail transportation policy of Section 10101A sets the tone for the Staggers Act and provides some insight into Congressional intent.

The word "competition" is emphasized in 4 of the first 6 subparagraphs. The policy refers to the need:

In subparagraph 1: "To allow . . . *competition* and the demand for services to establish reasonable rates . . ."

In subparagraph 4: "To ensure . . a sound transportation system with effective *competition* among rail carriers . . ."

In subparagraph 5: "To foster sound economic conditions in transportation and to ensure effective *competition* . . ."

In subparagraph 6: "To maintain reasonable rates where there is an absence of effective *competition* . . ."

There is little doubt that while Congress sought to reduce the role of regulation, it recognized the need for competition to replace that role as a moderating force in the rail market.

Now we find ourselves in a void where the Commission continues to retreat from its historic mission to protect against abuses of market power while failing to implement the competitive safeguards referred to in the Staggers Rail Act.

The Staggers Rail Act was billed as a statute which would eliminate some of the more onerous aspects of Interstate Commerce Commission Regulation, and allow "free market forces" to govern. It was expected that the railroads would be strengthened financially as a result. Although many shippers were nervous about the powers that the Staggers Act appeared to grant, they supported the act because of several provisions which were expected to make rail transportation more competitive. However, actions taken by many of the nation's railroads, cancelling routes and closing reciprocal switching, have ignored the expressed intent of Congress in the Staggers Act to preserve competition in the railroad industry.

A chronology of recent events will serve to make the point:

July, 1981—Conrail restricts interterritorial routes.

August, 1981—Conrail cancels single factor joint rates on grain and grain products.

October, 1981—The Family Lines eliminates a variety of routings within the Southern Territory.

June, 1982—The Family Lines system restricts freight moving through New Orleans so that if it is destined for a point on the Family Lines, it must move out of New Orleans on the Family Lines.

July, 1982—The Southern Railroad puts in routing restrictions on freight moving through Memphis, TN.

August, 1982—The Seaboard Coast Line Railroad cancels joint routings with the Southern over Jacksonville, FL.

October, 1982—The ICC allows the Norfolk Southern Railroad to cancel its joint routings with the Burlington Northern at Birmingham, AL.

November, 1982—Conrail restricts routings on shipments moving wholly within the Official Territory so that if both origin and destination stations are located on Conrail, then the shipment must move directly over Conrail lines.

November, 1982—The Chessie System retaliates by closing reciprocal switching rights to Conrail wherever Conrail has restricted routings.

February, 1983—Norfolk Southern Railroad takes retaliatory action against Conrail similar to that taken by the Chessie System while Conrail prepares to close its industries to reciprocal switching.

March, 1983—Southern Pacific institutes joint rate/route cancellations throughout Trans-continental Territory.

April, 1983—The Atchison, Topeka, and Santa Fe Railway Company's restrictions on reciprocal switching become effective.

The significance of this series of route closings is that since the Mann-Elkins Act of 1910, the shipper has had the legal right to route his own freight as long as there is an established route available and filed with the ICC. By closing large numbers of routes, the shipper is denied alternatives, and is therefore made vulnerable to the potential for exploitive behavior that tends to follow the establishment of a monopolistic position. Those facilities which are served by only one railroad, are in a particularly difficult position. In the next several years, railroad rates could increase dramatically as railroads seek and are allowed to collect monopolistic profits. In addition, the merger movement, which was said to hold the promise of a more rationalized transportation network, takes on an ominous appearance now in light of recent events. The joining of regional railroads into mega-mile networks under single ownership portends massive closures of route alternatives for the future. The impact of such actions on shipper interests could be disastrous.

B. F. Goodrich Chemical has been adversely affected by the closing of competitive alternatives. For example, last year our freight, originating at our plant in Louisville, KY, could be shipped out via any one of six railroads to points within Official Territory. Today, Conrail has effectively excluded other railroads from participating in shipments destined for points that are local on Conrail. We no longer have a choice, but are "forced" to ship over a line which represents itself to be the most efficient alternative. If such "direct" service is, in fact, the most efficient available, why must I be compelled to make use of it? The lack of alternatives removes our power to bargain effectively for the freight we have available, and finally results in our paying an artificially inflated price for railroad service.

Finally, the cancellation of joint rates will create the need for individually negotiated legs on a through movement from origin to destination. In this way, the business of shipping, already complex, must surmount the additional hurdle of multiple negotiations for separate shipments. Costs, such as those associated with freight bill audit, will increase proportionately.

We are seriously concerned with the present turn of events. We had expected to see an expansion, not a contraction of reciprocal switching, and we had hoped to see gateways opened, not closed as a result of the Staggers Act. We believe that remedial legislation is needed to prevent the misuse of the powers granted by the Staggers Act, and to give a clear directive to the Interstate Commerce Commission to fully consider the effects of its decisions on the competitive environment.

STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

EXECUTIVE SUMMARY

The Staggers Rail Act was intended by Congress to reform railroad regulation by allowing railroads greater flexibility in setting prices. As a check to this power, Congress expressed a need to protect captive shippers—those shippers who have no transportation alternative to railroads—against abuses in rates and services. The Act also sought to promote rail-to-rail competition in the interest of reducing transportation costs.

In implementing the Staggers Rail Act, the Interstate Commerce Commission's record to date does not reflect the balance envisioned by the Congress and can be fairly characterized as extremist in shifting power to the railroads at the expense of captive shippers. For example, the Commission has exempted from the Act's effective provisions: (1) Whole commodity groups such as coal and various agricultural commodities; (2) methods of shipment such as "box car" and "trailer on flat car", totally ignoring the interests of affected captive shippers in the process. Furthermore, the Commission has allowed several major rail carriers to cancel joint rates and through routes, as well as reciprocal switching agreements, resulting in the elimination of rail-to-rail competition—again in the contravention of congressional intent.

The National Association of Manufacturers strongly supports congressional oversight of the Staggers Rail Act. At a minimum, the Congress should demand the Commission assess the cumulative impact of its decisions on captive shippers and consider whether additional legislation is necessary to fulfill the true objectives of the Staggers Rail Act.

STATEMENT

The National Association of Manufacturers (NAM) appreciates this opportunity to submit its views for the record on oversight of the Staggers Rail Act. The NAM is a voluntary business organization of approximately 13,000 members and has affiliations through its Associations Department and the National Industrial Council with an additional 158,000 businesses. NAM members account, in the aggregate, for nearly 80 percent of the nation's industrial output and 85 percent of the nation's industrial workforce. As the nation's major manufacturing business trade association, NAM is vitally concerned with promoting the competitive interests of our members who are captive shippers or who rely on captive shippers in doing business.

NAM supported passage of the Staggers Rail Act principally because our members viewed the legislation as a well-balanced approach to the disparate objectives of securing adequate railroad revenues and providing captive shipper protections. The potential for harm to captive shippers was fully considered by the Congress in drafting the legislation. Staggers underscored the need for a "procompetitive" balance in providing the Interstate Commerce Commission with a statutory duty to protect captive shippers from price gouging and other economic harms resulting from the lack of effective transportation competition.

However, the Commission's regulatory decisions in implementing the Act, particularly those decisions involving the definition of market dominance, railroad revenue adequacy, and coal rate guidelines, appear to have disadvantaged captive shippers and have permitted the railroads to engage in monopolistic activities. By virtue of these decisions, the Commission has exempted from the Act's effective provisions: (1) Whole commodity groups such as coal and various agricultural commodities; (2) methods of shipment such as "box car" and "trailer on flat car," totally ignoring the interests of affected captive shippers in the process. This policy undermines the intent of Staggers to promote competition in rail services and to ensure reasonable rail rates.

Captive shippers are those shippers who lack viable transportation alternatives and, so, are "captive" to the railroads. A Commisison sponsored study by Kearney Management Consultants, designed to promote the Commission's rail carrier policy, estimated that 10 to 15 percent of rail traffic is market dominant or captive. Even though these percentages are significant, they are misleading in understating the magnitude of the captive shipper problem. This is true because the consultants used the Commission's definition of market dominance as the sole criterion for quantifying the extent of captive traffic. The Commission's limited definition of captive shipping is based on insufficient criteria and is unsupported by Staggers as the 5th Circuit Court of Appeals has ruled in Western Coal Traffic League, et al vs. ICC.

Captive traffic can exist for a number of independent reasons:

It is possible for the geography of certain terrain to preclude transport by any means other than by railroads;

Marketing considerations such as product liability, bulk transport requirements, or hazardous materials transport prohibitions may dictate a captive dependency;

Seasonal traffic demands may be met solely by rail carriers because of excess capacity capabilities on rail systems;

The lack of an available transportation service alternative presumes captive traffic; and

Monopolistic rail carrier practices including the blanket cancellations of through routes and joint rates, the cancellations of joint use of terminal facilities and reciprocal switching agreements result in the elimination of service competition and create captive traffic.

In addition to these causal factors, the railroads have engaged in activities, condoned by the Commission, that have exacerbated the captive shipper problem:

The initiation of restrictive routing;

The practice of resistance to implementing the Staggers entry reforms dealing with reciprocal switching, trackage rights, the opening of gateways, and the extension of rail lines; and

The monopoly-like extraction of higher rates from captive shippers.

The Commission has given credence to these railroad practices by reversing a long-standing policy to suspend and investigate all route cancellations effectively giving the railroads carte blanche to cancel such service agreements. The Commission has also adopted a cross-subsidization scheme that allows a rail carrier to charge captive shippers a disproportionately greater amount of the carrier's fixed costs.

The NAM has identified a need for your Committee to consider legislation that addresses each of the following concerns:

Determination of reasonable rail rates for captive shippers;

Determination of railroad revenue adequacy;

Determination of railroad market dominance;

Prohibition against exemption of market dominant traffic; and

Prohibition against anti-competitive rail actions such as cancellation of through routes, joint rates and reciprocal switching agreements.

STATEMENT OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

I. INTRODUCTION

This statement is submitted for the record to the Senate Committee on Commerce, Science and Transportation's Subcommittee on Surface Transportation on behalf of the National Association of Regulatory Utility Commissioners (NARUC).

The NARUC is a quasi-governmental, nonprofit organization founded in 1889. Within our membership are the governmental agencies of the fifty States and the District of Columbia, Puerto Rico and the Virgin Islands engaged in the regulation of utilities and carriers. Our chief objective is to serve the consumer interest by seeking to improve the quality and effectiveness of public regulation in America.

As the representative of the State agencies which regulate intrastate railroad operations we are strongly opposed to the Federal preemption of legitimate State authority to oversee intrastate rail rates. In addition, since our member agencies must ensure reasonable and equitable retail rates for electricity, the NARUC is particularly concerned with the effect of the Interstate Commerce Commission's (ICC's) implementation of the Staggers Rail Act[1] on electric utility ratepayers. The members of the Association are fearful that the ICC's proceedings to formulate uniform coal rate guidelines[2] and to certify State commissions to maintain limited jurisdiction over intrastate rail rates[3] will adversely affect consumers by reducing the Act's protections for captive coal shippers and the States' ability to be responsive to the needs of both shippers and consumers.

Because of the importance of this issue to the continued viability of the regulatory programs of the States, the NARUC applauds the members of the subcommittee for convening oversight hearings on the current status of the Staggers Act. The remainder of this statement will concentrate on the above-mentioned proceedings and will include background information on the Act and its impact upon the States, as well as recommendations for much-needed reform.

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[1] Public Law 96-448.

[2] Coal Rate Guidelines—Nationwide Ex Parte No. 347 (Sub No. 1).

[3] State Intrastate Rail Rate Authority Public Law 96-448 Ex Parte No. 388.

II. PREEMPTION OF STATE AUTHORITY TO REGULATE INTRASTATE RAIL RATES

The membership of the NARUC strongly objects to Section 214 of the Act[4] which requires each State seeking to maintain jurisdiction over intrastate rail rates and services to obtain permission to do so from the ICC.

This provision has radically altered the system by which the States, acting through their regulatory commissions, exert jurisdiction over the intrastate rates of rail carriers operating in interstate commerce under authority granted by the ICC. Section 214, in effect, removes from State agencies all independent regulatory authority over intrastate rail states rightfully derived from their state enabling statutes.

In order to certify States seeking to maintain intrastate jurisdiction, the ICC has mandated in Ex Parte No. 388 that the State commissions prepare highly detailed and complex rules for ICC review and approval. These rules must ensure that the States mirror the ICC's ratemaking decisions. If the submissions fail to comply with this mandate, the states must sacrifice their intrastate rail ratemaking authority entirely. In essence, the States have the same unenviable decision as the ancient Greek mariners in choosing between Scylla and Charybdis: either they become mere "rubber-stamps" for the ICC or they lose all authority over intrastate rail operations. To further complicate this process, due to numerous delays by the ICC, only one State out of 35 seeking permanent certification has received ICC approval to regulate intrastate railroad operations in the three years since the Act was implemented.[5]

In order to better understand the impact of the Act on this area of traditional State authority, a brief history of State rail regulation follows.

A. History of State rail regulation [6]

Interstate rail commerce was first subjected to ICC jurisdiction in 1887 with the passage of the Act to Regulate Commerce.[7] The States had sole jurisdiction to regulate intrastate rail commerce until 1914 when the Supreme Court decided the *Shreveport* rate cases.[8] In its decision, the Court held that the ICC had the authority to establish intrastate rate levels in cases in which intrastate rates, even though lawfully established by a State commission, discriminated against interstate commerce. However, primary authority over intrastate rates remained at the State level.

In 1976 Congress enacted the Railroad Revitalization and Regulatory Reform Act (4-R Act)[9] which provided that the ICC could prescribe an intrastate rate if a rail carrier requested an increase and the State had not acted on the matter within 120 days. This provision reserved primary intrastate rate jurisdiction with the States so long as they acted expeditiously.

In fact, prior to section 214, neither Congress nor the judiciary had ever sanctioned the broad, Federal preemption of State rail ratemaking, presently envisioned by the ICC. Instead, a case-by-case ICC review was preferred in order to ensure that rate cases were settled within 120 days and to remove any undue burdens upon or unjust discrimination against interstate commerce.

B. The current status of State rail regulation under section 214 of the Staggers Act

In place of the straightforward language of the prior law, Congress created a more complicated regulatory scheme when it enacted the Staggers Act in 1980. According to the provisions of the Act:

"State ratemaking statutes, regulations, and policies which conflict with Federal law have been effectively repealed;

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[4] 49 U.S.C. sec. 11501.

[5] Virginia received permanent certification on July 27, 1983 subject to minor modification of its standards. The other States which are seeking certification are: Alabama, Arkansas, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Michigan, Montana, Minnesota, Mississippi, Missouri, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Utah, Washington, West Virginia, and Wisconsin.

[6] For a more detailed discussion see Gray, Charles D., "State Authority To Regulate Intrastate Rail Rates Under the Staggers Act," Western Transportation Law Seminar, pp. 71-78 (1982).

[7] 24 Stat. 379.

[8] *Houston E. & T. Ry. Co.* v. *United States*, 234 U.S. 342 (1914).

[9] 90 Stat. 31.

"State jurisdiction over general rate increases, inflation-based increases, and fuel adjustment surcharges is completely preempted (and even ICC oversight of similar interstate increases has been restricted);

"States must regulate intrastate rail rates pursuant to Federal law;

"The ICC no longer has Shreveport authority to review State decisions to remove substantive burdens upon interstate commerce, instead the Commission may review and revise State decisions solely on the basis that the State had rendered its decision using regulatory standards not in accordance with Federal law; and

"States are required to become certified by the ICC in order to continue regulating intrastate rail rates.

Based on the history of State rail regulation, section 214 represents an unwarranted intrusion into an area of traditional and indisputed State sovereignty. As enacted, States may not deviate from Federal law in setting rates. In addition, in order to be able to implement the Federal law, the States must receive ICC certification. Intrastate rates in non-certified States are subject to exclusive ICC authority.

In order to receive certification, according to the provisions in the Act, the States were to submit to the ICC by January 1981 the standards and procedures each intended to use in exercising intrastate ratemaking authority. Reversing an earlier notice that detailed filings were not required, the Commission asked for extensive documentation of each State's program. Despite guidelines jointly prepared by the NARUC and the ICC to assist States in providing the ICC with the information necessary to achieve certification, no State was certified until July 1983.

The heart of the problem confronting the States as they grapple with the ICC's certification standards is the extent, if any, of permissible State discretion in regulating intrastate rates. Unfortunately, neither the Act nor the ICC have provided clear guidelines for the States to follow in developing the necessary submissions in order to retain intrastate jurisdiction. In the meantime in numerous decisions over turning State-imposed rail rates the ICC has, in effect, held that if State decisions vary from the ICC's interpretation of the Act, the State rates will be overturned.

In sum, section 214 establishes a two-step process to force State regulators to employ Federal law to decide intrastate rail rates: to avoid complete Federal preemption, a State commission must receive ICC certification of its standards and proceedings; and, to avoid ICC reversal of its decisions, a State commission must exercise its authority in accordance with the ICC's perception of the requirements of Federal law. The effect of this section has been to stalemate any State effort to oversee the rates charged by the railroads to transport coal.[10]

III. ICC COAL RATE GUIDELINES (EX PARTE NO. 347)

Also of concern to the NARUC is the erosion of the captive shipper protections contained in the Act. Captive shippers, including many electric utilities under State commission jurisdiction having no alternative to rail transportation for coal shipments, must be protected from the exercise of the monopoly pricing power of the railroads which serve them. This means that these shippers must have access to the State commissions and the ICC for the prompt redress of discriminatory action or unreasonable rates imposed by the railroads.

The NARUC's concern for captive shippers derives from two sources. First, pursuant to State laws, State regulators have been charged with the duty of protecting all shippers, particularly those that have historically possessed less bargaining power by reason of size or availability of alternate transportation, from unfair rail pricing practices.

Second, State commissions are also charged with the duty of ensuring that the rates and services of electric utilities are fair and equitable for electricity ratepayers. The amounts which utilities pay for coal transportation, which are typically passed through to consumers, should reflect the cost of the service provided. Under no circumstances should rail carriers be permitted to cross-subsidize competitive market activities by exacting higher fares from captive shippers.

For these reasons, the Association's Executive Committee, during its 1983 Summer Meeting, expressed its opposition to the proposed ratemaking policies developed by the ICC in Ex Parte No. 347 (Sub No. 1).

If adopted, the ICC coal rate guidelines would allow railroads to raise the rates charged to transport coal up to fifteen percent per year without any type of regulatory oversight. Increasing the opportunity for rail carriers to raise transportation rates will result in higher prices paid by consumers for electricity produced by coal-fired electric utility generating plants.

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[10] The NARUC is currently involved in litigation challenging the constitutionality of section 214, *State of Texas, et al.* v. *United States, et al* (U.S. Court of Appeals for the Fifth Circuit Docket No. 82-1693) and the ICC's implementation of the Act in various State rate cases. Nothing in this statement is intended to prejudice the NARUC's position in any of those proceedings.

The Commission's plan would impose four so-called constraints upon the maximum prices rail carriers could charge captive coal shippers. The constraints would be based on:

Stand-alone costs or the cost to the shipper of providing its own transportation services in isolation from other rail shippers;

Certain management factors whereby captive shippers would not be charged rates which reflect the cost of obvious management inefficiencies;

A fifteen percent phase-in to limit rate increases on captive coal traffic to fifteen percent per year after inflation; and

A revenue adequacy determination which would ensure that until a rail carrier became revenue adequate it would be free to increase its rates subject to the above three constraints.

These guidelines pose a real threat to electric utility ratepayers by sanctioning the unfettered exercise of rail monopoly power.

IV. STAGGERS ACT REFORM

The above-described proceedings illustrate that changes in the Act are needed in order to preserve State jurisdiction over intrastate rail rates and to limit ICC discretion in setting rail rates. The Association is pleased that legislation has been introduced in the Senate by Senator Wendell Ford, S. 1081 and S. 1082, and in the House of Representatives by Representative Nick Joe Rahall II, H.R. 2584, to encourage the ICC to balance the interests of both rail carriers and shippers. The measures would strengthen the Act by providing for more realistic definitions and standards of review for the ICC to follow in determining reasonable rail rates, railroad market dominance and revenue adequacy.

However, we would encourage the members of the subcommittee to remedy the problems encountered by the State commissions in attempting to retain their legitimate authority to regulate intrastate rail rates by abolishing the certification process.[11] In addition, in order to discourage the Commission from a perfunctory review and an inevitable reversal of State rate decisions, we would propose that the law prior to the passage of the Staggers Act be reenacted. This would ensure that the State decisions are afforded a proper review on the Federal level to guard against any interruption of interstate commerce. In addition, this proposal would not inhibit the ability of rail carriers to challenge intrastate rates.

The NARUC has consistently advocated that State participation is essential if the interests of consumers are to be fully defended.[12] Unfortunately, the current certification process renders the State commissions without any means to ensure adequate ratepayer protections. The intrastate traffic patterns in each State are unique and each State should be permitted to continue to seek to maximize the benefits of low cost transportation within its borders. By encouraging meaningful State consideration of intrastate rate cases, consumers and small shippers will be assured of an opportunity to be heard in a local forum before an agency which is in the best position to determine the local needs of both carriers and shippers.

V. CONCLUSION

Congress, in enacting the Staggers Act, rejected attempts to preempt State regulation of intrastate rail rates, and recognized the importance of a continued State role within the new regulatory environment. In addition, Congress charged the ICC with the responsibility of protecting captive shippers from railroad monopolies. The Commission, as it undertakes to implement the Act, must not subvert the intent of Congress through the administrative process. Rather, a meaningful State/Federal partnership must be established in which the government closest to the people has a voice in protecting their interests.

APPENDIX

Section . Section 214 of the Staggers Rail Act of 1980 (49 U.S.C. 11501) is hereby repealed.

Section . Section 11501 of the Interstate Commerce Act is amended as follows:

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[11] See appendix for suggested language.

[12] See 92nd NARUC Annual Convention Proceedings, pp. 866–898 (1980).

(a) The Interstate Commerce Commission shall prescribe the rate, classification, rule, or practice for transportation or service provided by a carrier subject to the jurisdiction of the Commission under subchapter I or IV of chapter 105 of this title when the Commission finds that a rate, classification, rule, or practice of a State causes—

(A) between persons or localities in intrastate commerce and in interstate and foreign commerce, unreasonable discrimination against those persons or localities in interstate or foreign commerce; or

(B) unreasonable discrimination against or imposes an unreasonable burden on interstate or foreign commerce.

(b)(1) The Commission has exclusive authority to prescribe an intrastate rate for transportation provided by a rail carrier subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title when—

(A) a rail carrier files with an appropriate State authority a change in an intrastate rate, or a change in a classification, rule, or practice that has the effect of changing an intrastate rate, that adjusts the rate to the rate charged on similar traffic moving in interstate or foreign commerce; and

(B) the State authority does not act finally on the change by the 120th day after it was filed.

(2) When a rail carrier files an application with the Commission under this subsection, the Commission shall prescribe the intrastate rate under the standards of subsection (a) of this section. Notice of the application shall be served on the State authority.

(c) The Commission may take action under this section only after a full hearing. Action of the Commission under this section supersedes State law or action taken under State law in conflict with the action of the Commission.

Section . All cases pending before the Interstate Commerce Commission are hereby dismissed as of the date of enactment of the preceding two sections.

STATEMENT OF NATIONAL RAILWAY UTILIZATION CORP.

Members of the Subcommittee: Your Subcommittee presently is conducting oversight hearings regarding the Staggers Rail Act of 1980 and the actions of the Interstate Commerce Commission under that Act. Your timing could not have been better. As you know, the I.C.C. recently issued a decision substantially deregulating "boxcar traffic." That decision poses a disastrous threat to the continued operations of short line railroads, to the ability of the shippers served by short lines to retain access to the national railroad system, and to the very sizeable investment representated by the short line boxcar fleet.

National Railway Utilization Corporation and its subsidiaries operate five short line railroads: (1) The St. Lawrence Railroad, in upper New York State, (2) Pickens Railroad Company, in South Carolina, (3) the Mississippian Railway, Inc., in Mississippi, (4) Graham County Railroad, Inc., in North Carolina, and (5) Peninsula Terminal Company, in Oregon. This group of carriers is responsible for the operation of over 2,000 boxcars.

The I.C.C. boxcar decision, which authorizes terminating railroads to store foreign cars without paying per diem and to assess charges for the return of empty foreign cars to their owners, will turn what are not marginally profitable short line outbound movements into deficit producing movements with mathamatical certainty. The cost for us to retrieve an empty boxcar which has traveled a thousand loaded miles will be $350.00 under the empty return rates authorized by the I.C.C., and $700.00 for a car that has traveled 2,000 miles, in either case an amount far in excess of what our modest revenues bring us. These costs, or course, cannot be absorbed by the short lines and we seriously doubt that they can be absorbed by most of our shippers if we attempt to pass them on in the form of increased freight rates. If the I.C.C. boxcar deregulation decision is implemented, the inevitable result will be the loss of virtually all short line boxcar originations and the consequent collapse of many short line railroads.

The I.C.C. decision argues that the boxcar deregulation is necessary in order for railroads to be placed in a better competitive position through cost reductions. That argument, however, is misleading at best. The so-called cost reductions envisaged by the I.C.C. are in the form of car hire eliminations (per diem reclaim) and empty movement charges; destination carriers would be relieved of the existing obligation to pay per diem on cars which they have unloaded and choose to store for their own business convenience and are given the authority to charge $.35 per mile or more for the return of empty cars.

This does not represent a cost savings to the railroad industry, but instead a cost reallocation, requiring originating railroads to absorb, or pass on to their shippers, the terminating carriers' "savings" in car use charges allowed by the I.C.C. I respectfully submit that it is not a proper regulatory excercise for the I.C.C. to mandate that the use costs of railroad cars be transfered from those who use the cars and derive the primary benefit therefrom to those who supply the cars. Throughout the 1960s and 1970s, the Congress and the I.C.C. took a series of very clear steps to encourage an influx of new railroad cars in order to overcome the chronic car shortages created by the major railroad industry. Through "per diem" legislation you directed the I.C.C. to take steps designed to insure that car owners received from car users the owners' current costs of care ownership. I believe that you have a responsibility to insure that the substantial long-term investments made as a result of your policies not be dishonored.

Some parties have suggested that the intolerable results of the I.C.C. deregulation decision should be countered through the adoption of a narrow exemption for boxcars that were acquired "primarily" to serve shippers located on Class III (short line) railroads or acquired by Class III railroads that are owned by a single shipper. We vigorously oppose that "solution" and consider it to be impractical, unworkable, and unfair. We see no justification for a solution which retroactively concludes that a Class III railroad which acquired cars that were needed and desired by Class I railroads should no longer be treated as part of the national railroad system and singled out for extinction.

In reviewing the recent actions of the I.C.C., I urge your Subcommittee to take a highly critical view of the I.C.C. boxcar deregulation decision and to refrain from endorsing narrow, self-serving exemptions as a solution.

Statement of Harlan M. Niebling, on Behalf of North American Wholesale Lumber Association, Inc.

My name is Harlan M. Niebling, and I serve as Executive Vice President and Secretary of North American Wholesale Lumber Association, Inc. (NAWLA), located at Suite 680, 2340 South Arlington Heights, Illinois 60005, (312/981-8630).

North American Wholesale Lumber Association is a trade organization of approximately 515 firms. Membership consists of 342 independent wholesaler distributors of forest products, 123 Associate Member forest products manufacturing firms and 50 Affiliate Members who provide services, including transportation, to the distribution of forest products. Our members can be found in 46 states and 5 provinces of Canada.

My statement is on behalf of the aforementioned 342 wholesale distribution firms who consititute our Active membership in the Association. These independent wholesalers distribute up to $10 billion annually in forest products, predominantly softwood lumber. The size of these firms varies individually from less than $1 million in annual sales to over $400 million in annual sales. The majority of members transact business in the $5 to $50 million range annually.

Our interest in both rail and motor carrier deregulation legislation predates the passage of such legislation. Lumber and other wood products are generally bulk products. The cost of transporting same from manufacturer to the marketplace can often be from 30 percent to 40 percent of the marketplace cost, depending on the product item's FOB mill value. Prior to passage of The Staggers Act of 1980, we supported the concept of deregulation and the specifically stated goal in Section 3 of the law, "To provide a regulatory process that balances the needs of carriers, shippers and the public."

Conversely, we did have concerns about this legislation prior to passage and its potential effect on our industry. Additionally, there were expressed doubts by some of our member companies regarding the implementation of the legislation by the Interstate Commerce Commission.

Initial fears by our wholesale industry were in the areas of car supply and rail contracts. While the economic slump has so far delayed car supply problems, the implementation by the ICC in rail contracts has affirmed our initial concern.

The current activity on the part of some rail carriers on joint rate and route cancellations and reciprocal switching arrangements has simply added more concerns on the part of the small and medium-size shipper.

The pending Box Car exemption by the ICC is another area which concerns the members of this Association. It seems to be opposed by nearly everybody but the ICC and one government-owned rail carrier. It seems certain to affect the smaller railroads at both origin and destination where frequently, in our industry, they are located.

Joint Rate and Route Cancellations.—The actions by some rail carriers in this area certainly do not foster the "competition between railroads" nor do they serve the public. There are too many situations where we are not talking about costs of service but rather an anti-competitive action that can affect market penetration by product and competitiveness between firms using the transportation system.

Example: A lumber distributor (retailer) in Los Angeles is located on the Santa Fe. His lumber from the Pacific Northwest originates on the Southern Pacific which cancels switching arrangements. Retailer's only option is to transload product and haul it to his location or attempt to find product that originates on the Santa Fe.

Purchaser of Transportation.—Staggers does not really define who is the "purchaser of transportation." Many lumber contracts call for incentive rebates based on volume. Shippers (mills and sometimes wholesalers) in our industry often find it possible to have buyer pay the freight bill but control the routing and receive a per car rebate.

Additionally, this purchaser of transportation has other liabilities such as overcharges, loss/damage claims and no control over the rate charges. The carrier giving the rebate often does not have to offer an incentive to shipper to route via carrier's line because the shipper is geographically tied into this carrier only. Still, these types of contracts and instances continue to increase. In effect, this type of refund is a gift rather than an incentive and neither the buyer nor the consumer of product receives any value.

Example: A recent example of how these rebate contracts can become ridiculous concerns a wholesale marketing firm that had a contract with a bridge carrier. They also had a sales agreement with a large supplying mill in Canada. The contract called for per car rebates based on volume if routed over the contracting carrier. The contract was cancelled by the carrier under terms of the contract. Carrier then went to the supplying mill and offered a better incentive rebate program. How this would benefit the carrier when the wholesale marketing firm continued to be the sales agent of the mill puzzles this office, the wholesaler and the mill. Perhaps it is simply a case of the carrier being confused about who was selling the product, but it was simply a "gift", not an incentive.

It is the view of this Association that the purchaser of transportation is the party who pays the freight bill and not simply a party to a transaction that happens to enjoy advantages which allow them to dictate route and carrier while absolving themselves of all problems and liabilities by selling FOB mill.

Contracts.—The concept of rail contracts is that a rail carrier can utilize this opportunity to increase business, make a profit and perform at a lower rate which benefits the public. We can embrace this concept as well as the concept of economies of scale that might be inherent in volume shipments. Yet, there is a point at which the volume concept could lead to destructive pricing in the lumber industry. This concern is compounded by the fact that Staggers calls for freight rates that will provide the carriers with revenue exceeding their variable costs.

If the construction of a market price at destination includes transportation costs of 30% and the normal cost of the wholesale distribution function (wholesale margin) is in the area of 4–7%, then there is adequate room for destructive pricing on the part of the volume shipper.

It must be recognized that deregulation of an industry will create new marketing problems and opportunities for those who depend on the services of the deregulated industry. Yet, there should be some limit to how far such deregulation should affect whose who depend on that industry. Should a lumber company have to close its door because of transportation alone? Should a shipper who actually ships more volume than another pay a higher price for his transportation because he signed a contract prior to his competitor? Should a carrier be allowed to provide transportation at cost or even below cost to the large shipper and ask the smaller shipper to pick up the difference through increased regular freight rates? We submit that all of these questions could occur.

We urge the Senate Subcommittee on Surface Transportation to continue to study the problems of The Staggers Act and to examine the environment of the small shipper and the captive shipper.

STATEMENT OF MARY W. NIELSEN, TRANSPORTATION CHAIRMAN FOR W.I.F.E.

Senators, my name is Mary Nielsen, and I speak on behalf of Women involved in Farm Economics as Transportation Chairman. My thanks to the committee for allowing the extra two weeks for testimony to be submitted on the Staggers Act. I feel that the Senators should be aware that our organization is representative of over 20 states—our members are almost all directly involved in the production of agricultural commodities, and we receive no financial aid from any source other than our members.

Transportation affects all commodities and areas differently, but, because we feel strongly that what affects one segment of agriculture affects us all, I can testify on behalf of all our members. We also feel that whatever affects the economy of agriculture also affects our nations' economy.

I was in Washington, D.C. during the hearings and had asked to participate as a representative of a producers group, but was told that the witness list had already been chosen. WIFE protests the fact that there was no agricultural producer group represented on the panel, but after listening to the testimony, it was obvious that many felt as our organization does, that: No. 1, There must be a balanced transportation system serving our country, and No. 2, Chairman Reese Taylor of the ICC spoke for many when he said that "Effective competition is the key to the Staggers Act". The third noticeable conclusion was that it is vital that Congress enjoins the ICC to enforce the provisions in the Act as Congress intended, and No. 4, if they do not, or need more guidance, then Congress will have to protect the shippers for them, by passing further, more restrictive legislation.

One of the goals of Congress, written into the Act, was to provide a regulatory process that balances the needs of the carriers, shippers, and the public. Another was that it is "to assist the rail system to remain viable in the private sector of the economy".

Since much of the testimony at the hearing stressed that the railroads have come through a recession with improved financial status (thereby proving that the Staggers Act works, according to some!) and there were at the same time, so many complaints from large shippers, it would indicate that the ICC is not "balancing the needs of the carriers, etc.," Most of the shippers were in favor of the provisions of the Ford/Rahall bills, and WIFE concurs, with the following comments!

1. The terms "captive shipper" and "market dominance" should be well-defined, interpreted by the ICC in conjunction with the individual state Department of Transportation, since there is so much variance in the transportation systems from state to state. We also agree with the many protests about the standards being used by the ICC for the definition of competition—intermodal, intramodal, geographic and product competition. This could be interpreted to mean that there is no "market dominance" anywhere in wheat producing states, since there are other areas that produce wheat! This would make it impossible for some areas to compete for export markets because of their higher freight costs. The controversial decision in Ex Parte No. 347 has for years been applied to Montana shippers, where grains compete for markets with those from states farther East, while paying higher freight charges in competition with grain going right through the State to the same destination! Because of the lack of intramodal competition! It seems obvious that bulk commodities such as coal, grain, fertilizer etc., should be moved in the most efficient way—by rail—and that alone indicates more "market dominance" than the railroad, or the ICC, cares to admit! We are opposed to the geographical and product competition standards.

2. A well-defined, standardized formula such as proposed in the Ford/Rahall bills is vital. With many others, we urge Congress to fund the Railroad Accounting Principles Board, as defined in the Staggers Act. We further urge that, in addition to the present qualifications for this Board, that there should be no more than three Republicans, with no restrictions on the political affiliations of the other members. Three should be from widely different geographical areas, so that all sections of the country be represented.

3. The provisions of contracts involving agricultural commodities should be made available to those who feel that they are being adversely affected. At this time, under the present interpretations of the ICC, the only way a shipper can have any knowledge of a contract between the railroad and his competitors is the price that can be offered to the producer for his grain—the "margin" (operating expense) can be reduced as the freight costs are lower. This restricts competition unfairly, and is against the provisions of the Act.

4. Congress should enforce the prohibitions against demand-sensitive rates or seasonal rate-making.

5. New rate increases on agricultural products should not become effective until 30 days after the rate has been published. Grain shippers cannot make informed marketing decisions, since they cannot be sure of the rates ahead of time. Elevator managers have to take larger "margins" to protect themselves against increases.

Also, there has to be a provision made for rate reductions when the inflation rate goes down! Early this year, no reductions were made when the cost of fuel declined dramatically, although some shippers protested to the ICC. S. 1081 would require the railroads to decrease their rates when there is a concomitant reduction in costs.

In the original Staggers Act, a Shippers Needs Board was proposed; we urge that this be reconsidered. An authority that is conversant with the law that could advise or direct shippers who feel that they have a problem. This Board would also be useful in gathering information about the weaknesses in the law through the problems that it encountered. The Nebraska Grain and Feed Dealers Association, in its excellent testimony, said on page 8: "it should be fully defined in the law that small shippers can bargain collectively with the railroads on grain contracts, but they'll need the rail cost information and the assistance of some public body to do this". A Shippers Needs Board would be ideal in this situation. This provision of the law could be utilized by small elevators on a branch line forming a Shippers Association to pool their shipments in an effort to preserve their branch line service. Such an association has been formed on a 146 mile long branch line in Northeast Montana. 23 elevators—both privately owned and cooperatives—have banded together in an effort to preserve their own businesses, the 16 small towns that they serve, the long distance roads in the area, and the tax base for the counties involved. They asked the Burlington Northern railroad for a contract last year, promising to guarantee x number of bushels annually in return for a 52 car multi-origin rate that would be the same as the single origin 52 car rate now offered the line. Presently the train goes up the line one day and back the next, all week, and the users felt that this would not appreciably increase their costs, especially when at times several engines pulling just a caboose goes up and down the line when there is no other business!

The contract was not even considered, the railroad urged that a large single-origin facility be built on the line, even though farmers perceive that it is not economically feasible, since the area grows varied grains—some of which are not usually sold in 52 car lots (few want 171,600 bushels of Durum wheat for pasta)—and the area residents are apprehensive that the branch line will continue to be allowed to deteriorate, or that the rate differential between the branch line and the main line will increase, causing farmers to haul more to the main line, and creating a de facto abandonment. In some instances, grain will have to travel over 100 miles to the main line, but the BN is virtually assured of getting the bulk of the grain.

Under the present accounting principles allowed by the ICC, a marginally profitable line may not be attractive for the railroad to retain, but a good profit decision for the railroad may adversely affect the profits of scores of small businesses. Railroads may balk at operating lines that are in poor shape, through no fault of the affected communities which have done business with the railroad for decades, and would like to continue doing so. A monopolistic company that has encouraged community dependance on its services should have a responsibility not to make it unprofitable for the shippers to use the line.

In such obvious cases of market dominance where the railroads have "cannibalized" the branch lines—i.e. taken profits from the line while allowing the trackage to deteriorate to a point where the line has to be embargoed for safety reasons—then the ICC must step in to protect area shippers from the excessive impact costs, especially in areas where the railroad is very confident that it is forcing the shipments to its main line facilities by truck.

This is an obvious imbalance of transportation services, and when a possible 500 miles of roads are being adversely affected, then it is necessary for Congress to write an addition to Sec. 202—"Market dominance" of the Staggers Act—including "community impact considerations". In most instances, the cost of maintaining service by rail is much less than utilizing the roads for these bulk shipments.

WIFE feels that in all proposals for deregulation, the Congress should mandate that any and all deregulation should take place only so far as it causes no imbalance to shippers who are unable to protect themselves. It is an imbalance when the Act allows the railroads discriminatory pricing practices to affect the intermodal competition e.g. The more traffic that is directed on to the roads by the branch line abandonments directly affects the taxes that the trucking industry has to pay for the damage it causes to the highways in most states, therefore increasing their costs, affecting their ability to compete with the predatory pricing of the railroads.

WIFE agrees with Sen. Long's comment that "attempts by the rail to drive barges off of the rivers has been done for years, and they will continue to try to do that."

There are many difficult decisions ahead for the ICC, and yet, the commissioners cannot agree among themselves. At this time, since there are only 4 all of the Administration party, it would seem likely that any ruling made by the Commissioners could be contested in the courts as illegal, since there should be at least 7 commissioners—from both political parties. Those seats on the Commission should be filled immediately, thereby assisting the present Commissioners in their decisions. Care must be given to those vacant seats, placing special attention to the experience, objectivity and impartiality of the person nominated with respect to the treatment of carriers, shippers and the public.

WIFE echoes the remarks of Mr. Ogden (NCA) in comments that "the present system of the ICC's judgment of a fair rate of return to the railroads, even though in reality, a railroad has adequate revenues to maintain financial soundness, blind adherence to a target rate of return calculated using a grossly overstated rate base will lead the Commission to forever judge the railroads to be revenue inadequate."

Senator Danforth commented on the "malfunctioning of the ICC" and we can only add that while Congress originally instituted the ICC to protect the shippers from the predatory railroad, that body now takes advantage of the Staggers Act to protect the railroads from the shippers, and unless they want reregulation, the railroads had better start acting responsibly, or shippers such as coal companies, energy utilities, agricultural producers, as well as other modes of transportation will all rise up and protest, calling for more regulation.

WIFE, therefore, urges Congress to demand that the ICC does as Congress intended, protecting the shippers while allowing the railroads to become financially stable in an environment of effective competition. We also urge Congress to remember that agricultural shippers are the only industry that pays all the freight charges on all it produces and on all it uses, without the opportunity to pass those costs on.

STATEMENT OF THE NORTH DAKOTA PUBLIC SERVICE COMMISSION

Under North Dakota Law, the North Dakota Public Service Commission represents North Dakota on transportation regulation both intrastate and interstate on railroads and motor carriers covering rates and services. The three present Commissioners are Bruce Hagen, Leo Reinbold and Dale Sandstrom. Bruce Hagen serves as President, and all three Commissioners have equal powers. This statement is submitted on behalf of all three Commissioners.

North Dakota is heavily dependent upon rail transportation to assist in the annual movement of as much as 476 million bushels of the various grains produced in the state much of which moves long distances to ports for export.

Because of its dependence upon rail transportation, its isolation and relative captivity North Dakota has, since its inception, participated fully in the regulatory process.

It is difficult to give a critique of the Staggers Act as it was meant by the Congress to apply, but it is not so difficult to criticize the implementation of the Act by Interstate Commerce Commission (I.C.C.) Commissioners in office since the Act was passed.

It was not the purpose of the Congress to totally deregulate the railroads. It manifestly is the purpose of the Commission to deregulate them.

RATE REASONABLENESS

The following article from the July 11, 1983 "Traffic World" magazine, page 50, by an administrative law judge with many years experience at the I.C.C. tells it all:

"JUDGE CITES 'NEEDLESS' RAIL RATE LITIGATION

"ICC Administrative Law Judge James E. Hopkins has sounded a warning that shippers are wasting their time and money complaining to the ICC that railroad freight rates they pay are too high.

"Dismissing two complaints by Consumers Power Co. against rates various railroads charge it to haul coal from mines in eastern Kentucky to its plant at Erie, Mich., Judge Hopkins said the competitiveness of the market precludes the ICC from ruling on the reasonableness of the rates at issue, but he added that pursuing the issue of reasonableness would be fruitless anyway because the Commission's policy on rail rates would preclude a favorable decision for Consumers Power.

"Citing a recent Commission ruling that several railroads do not have a monopoly over the bulk of the nation's aluminum ingot traffic, the judge said that decision and its expected application to other complaints 'will end the usefulness of this Commission to the body of rail shippers.'

"Judge Hopkins said there was no reason to force Consumers and the defendent railroads to continue litigating the cases (No. 37857S, *Consumers Power Co.* v. *Norfolk & Western Railway Co.*, et al., and No. 38120S, *Consumers Power Co.* v. *the*

Chesapeake & Ohio Railway Co., et al.) 'when the policy decision appears to have already been made.' "

CONTRACT RATES

Section 208 of the Staggers Act allows railroads and shippers to contract for service. Other shippers can complain to the Commission on the grounds that the contract may impair the ability of the railroad to meet its common carrier obligation as to the complainant. Ports may complain of unreasonable discrimination. Agricultural shippers may complain of unreasonable discrimination if the railroad refuses to contract on the same terms and conditions as already exist for another shipper or if a contract constitutes a destructive competitive practice.

Based on the purported need for confidentiality the Commission refuses (see 367 I.C.C.) to require the railroads to disclose the essential terms of the contract. Obviously, if competing agricutlural shippers cannot ascertain the name of the contracting shipper, the specific origins and destinations and the rate or cost for the service they will not be able to prove harm to themselves.

The statute providing avenues of relief to alleviate discrimination and destructive competitive practices is subverted and rendered a nullity by Commission rule. North Dakota stands with the National Grain and Feed Association on this issue.

INTRAMODAL COMPETITION

The Rail Transportation Policy (49 U.S.C. 10101a) of the Staggers Act expresses the objective of the Congress to encourage competition:

(1) to allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail; (see S. 1082)

(2) to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes, to meet the needs of the public and the national defense;

(3) to ensure effective competition and coordination between rail carriers and other modes;

(4) to prohibit predatory pricing and practices, to avoid undue concentrations of market power, and to prohibit unlawful discrimination;

One of the goals of the Staggers Act is to "provide a regulatory process that balances the needs of carriers, shippers and the public . . ." In addition to he mandates of the Rail Transportation Policy concerning competition Sec. 11103 of the Act directs increasing railroad competition both through joint use of terminal facilities, through trackage rights, or otherwise and the establishment and implementation of reciprocal switching arrangements.

Once upon a time there were 128 Class I railroads in the United States. Now there are 38. Six rail systems merged into Conrail alone. In the 1940's, Minneapolis was served by nine railroads. Now it has four. We have all watched the formation, with the blessing of I.C.C., of several huge mergers. The Great Northern (GN), Northern Pacific (NP), Chicago-Burlington and Quincy (CB&Q) and later the St. Louis and San Francisco into the Burlington Northern (BN). The Union Pacific (UP), Missouri Pacific (Mo PAC) and Western Pacific (WP) into one system. The Norfolk and Western and the Southern into the Norfolk Southern system and many more. It is safe to say that the urge to merge is not yet dead. In fact the survival of some regional railroads will depend on it.

The multiplicity of competitive routes and service options once availale to shippers is being diminished in several different ways, and for several different reasons.

There is one school of thought fostered by regional railroads and a large body of shippers (The National Industrial Transportation League) that any diminution of rate, route and service alternatives constitutes a lessening of competition within the industry.

Large railroads take the position that maintaining rates and routes with other railroads between points they serve themselves needlessly inflates cost and prevents hard competition.

The I.C.C. has reversed its long standing mandate in merger cases that joint rates and routes over gateways existing before merger must be maintained after merger. A case in point would be a Great Northern, Minneapolis Soo route from Fargo, N.D. to Chicago prior to merger had to be maintained even though the GN merger with the Burlington gave it a through single line route to Chicago. The rationale was to preserve competition.

The Commission in Ex Parte 282, Sub 5, revoked all past routing conditions it has imposed in merger cases since the 1920's. This order has been appealed to the Federal Courts. Consistent with this order the Commission is allowing the wholesale cancellation of joint rates and routes, particularly by Conrail but also by other railroads. Prior to this decision, in addition to routes with other carriers mandated in merger cases, the railroads routinely interchanged traffic with each other providing shippers with numerous alternatives. A shipper at Chicago could use the Seaboard to Jacksonville, Fla. thence the Florida East Coast to Miami even though the Seaboard also serves Miami. A numbed of railroads serve between Chicago and Buffalo, but factories generally are served by one railroad. It has been possible for a shipper located on Conrail at Chicago to have a car switched to the Chessie at Chicago for Buffalo delivery. The Chessie in such a case would absorb Conrails switch charge.

Conrail led the way and is the chief actor in cancelling joint rates and routes with its rail competitors. It has established flat rates from its terminal to its own stations which require connecting railroads to establish flat rates to these termini on traffic to or from Conrail territory. These practices reestablish the combination of rates system prior to regulation and incidentally removes controversy over the division of through rates. It has cancelled joint line rates and routes on traffic which it can serve itself. It has increased switching charges by as much as 51 percent thus making it more difficult for another railroad to absorb the charge and still compete in price.

When the pervasive presence of Conrail's 17,000 mile system in the northeast is considered together with the fact that about 30 percent of the nation's freight traffic originates or terminates on Conrail, the Chessie System's charge that Conrail's goal is monopolization becomes somewhat believable. Not only shippers to Conrail but the rest of the country will be held hostage so far as rail transportation is necessary.

This sort of thing if proliferating on other railroads as well. The Southern, Burlington Northern, Illinois Central Gulf (ICG) and Southern Pacific (SP) are all engaged in joint rate and route cancellations which in turn demand retaliatory measures by competitors. It is not always the big boys who start the fights. BN recently cancelled joint rates and routes at Minneapolis with the Chicago Northwestern (CNW) and Soo on lumber from the west coast to Chicago and beyond. The BN did it because the CNW and Soo were offering shippers $100 per car rebate if they would route against the BN at Minneapolis. Obviously they considered their division of the total revenue to be profitable even when paying the $100 rebate.

If these actions continue, and they are being encouraged by the I.C.C., the so-called national railroad system will be a thing of the past.

To many shippers the scale appears to be weighted on the side of the large railroads. In fact some large shippers who originally supported the Staggers Act are having second thoughts. Contrary to the idea that a farmers' revolt back in the 1880's forced railroad regulation, it was the railroads themselves which pleaded for protection from each other. A Chessie System transportation official recently claimed the joint route cancellations, gateway closings, and switching reciprocity cancellations do not promote competition. They eliminate competition which formerly existed. Many industrial traffic managers find themselves caught in a cross fire between opposing railroads.

A B. F. Goodrich official is quoted in a trade magazine as saying: "The merger movement which was said to hold the promise of a rationalized transportation network, takes on a more ominous appearance now in light of recent events. The joining of regional railroads into mega-mile networks with single ownership portends massive closure of route alternatives for the future. The impact of such action on shipper interests could be disastrous."

These things are being said by shippers who helped fashion and supported the Staggers Act. Far from attempting to halt the proliferation of route cancellations it appears that the present Commission is prodding the rail carriers to compete in this fashion. Those railroads and shippers adversely affected by route canellations cannot look to the present Commission for relief.

If ever I.C.C. approved mergers and I.C.C. tacitly approved rate and route cancellations come out from under the antitrust exemption, Section 2, of the Sherman Act, dictating fair competition may be of some help to smaller, regional railroads, but it will be of little or no help to shippers caught in the middle of these internecine struggles.

INTRASTATE JURISDICTON

It is reported that although almost three years have elapsed since Staggers the I.C.C. has not granted any state permanent, unconditional certification to regulate intrastate traffic under the constraints of the Staggers Act. Florida and Illinois have made some progress, but the issue of whether an I.C.C. granted exemption from regulation federally extends to intrastate traffic is not decided. In any event, the delay in this area is unconscionable.

EXPORT COAL EXEMPTION

The coal and power interests will undoubtebly state their opposition to the exemption of export coal. North Dakota's interest is in preventing an extension of this concept to export grain. Some railroad personnel are already contemplating this parochial, exciting prospect.

MARKET DOMINANCE

The Commission issued guidelines for deciding whether a carrier has market dominance thus invoking its jurisdiction as to rate reasonableness. Under the guidelines the Commission would consider evidence that other carriers or modes of transportation compete for the same movement of the product to which the rate applies. Evidence was also admissable concerning "product" and "geographic" competition.

The U.S. Court of Appeals for the Fifth Circuit found that the statute limits the definition of market dominance to the transportation of the same product from the same origin to the same destination and remanded the order to the Commission for revision of its guidelines. We are aware of no further actions by the Commission.

In this connection Senate Bill 1082 seeks to revise the market dominance standard (Section 10709(d)(2) to include rates exceeding stated revenue-variable cost percentages, a market share exceeding 70 percent or substantial investment in railroad equipment or plant preventing use of other modes or railroads.

The Public Service Commission of North Dakota strongly supports this bill.

CONCLUSION

In our opinion, assuming we are going to have to accept some relaxation of railroad regulation, the Staggers Act is being faulted not so much in its substance, but in its implementation.

The Interstate Commerce Commission is outdistancing Congress in its zeal toward laissez-faire. While the President appoints these people the Senate consents and therefore bears some measure of responsibility. Both the President and the Senate could and should appoint people who realize the public interest means the public and not a "hands off," "eliminate all regulation," type attitude.

In a nutshell, we believe Congress should make sure the Staggers Act is being implemented. This means regulation not deregulation. Deregulation appears to be the Interstate Commerce Commission's course.

We regret we were not able to present our statement in person due to the full hearing docket. However, we wish to thank the Committee for accepting our remarks into the record for your committee and Congress's consideration.

STATEMENT OF NORTH DAKOTA STATE WHEAT COMMISSION

The North Dakota State Wheat Commission represents 40,000 wheat producers in the state of North Dakota. Annually North Dakota ships over 10 billion pounds of wheat by rail. That amounts to more than 50,000 rail cars per year.

The North Dakota farmers are extremely dependent on rail service to get their goods to market. Unfortunately, we often find ourselves with no alternative but to ship by rail. We have no inland waterways in North Dakota and we do not sit on the shores of any lake or ocean. Since our hauls generally range from 250 to 1,400 miles, truck competition is often not an adequate competitive substitute.

Unfortunately for North Dakota, we are served primarily by one railroad, the Burlington Northern. The Soo Line Railroad also serves portions of the state. However, very few origins are served by both railroads.

Because of the current economic environment, we have witnessed a very unusual phenomenon. Rail rates have actually declined in recent months and service has improved.

Some say that this is all the result of the Staggers Rail Act; however, that is simply not the truth. The minute that business picks up and the railroads no longer have an abundance of hopper cars, the rates will skyrocket and the service will deteriorate. Unfortunately, because of many regulatory changes brought about by the Staggers Rail Act, the shippers will not have the same opportunity that existed in the past to complain to the Interstate Commerce Commission about rail problems.

The North Dakota State Wheat Commission believes that the last thing that is needed is further deregulation of the rail industry. As a matter of fact, we would urge Congress to consider creating more stringent regulations particularly in the area of market dominance, captive shippers, and maximum rate levels. For example, shippers should be guaranteed an access to cost information from railroads for determination of important issues, such as market dominance, in freight rate cases. Similarly, an easy test should be created to demonstrate market dominance. Rates above a certain level of variable cost should be made illegal per se.

As noted above, the full impact of the Staggers Rail Act has not yet been felt by North Dakota farmers. However, dark clouds are already looming on the horizon.

Some thought that once the Staggers Rail Act was passed and the rail industry was re-regulated, contract rates would be the best thing since Mom's apple pie. It did take the Burlington Northern and Soo Line some time before they got involved in the area of agricultural contracts. However, recently this has changed and we have seen a number of grain and grain product contracts established. Certain shippers have received dramatic rate advantages as a result of some of these first contracts. It is extremely difficult to know exactly how much of an advantage has been gained because of the secret nature of the contracts. However, the word from the country is that certain elevators are finding it very difficult to compete because of the contracts entered into by neighboring elevators or grain firms. As a matter of fact, there are already some real concerns that not everyone will be able to make a contract; rather, it appears that the larger grain firms have a strong advantage in this area. One course of action which the North Dakota State Wheat Commission would recommend is that the law regarding the secret nature of rail contracts be loosened up so that more of the terms of the contract would be known to everyone. Without knowledge of the terms of the contract (such as the level of the rates, origins and destinations, number of cars involved) it is nearly impossible to determine whether the contracts are discriminatory or unreasonable.

Another area which is of much concern to North Dakota wheat producers, as well as the Soo Line Railroad, is the recent activities of the Burlington Northern and other major railroads to eliminate joint rates and routes, as well as to close gateways. For example, the Burlington Northern will no longer allow Soo Line cars to travel over its tracks from Minot, North Dakota, to the Pacific Northwest ports in Washington and Oregon. As a result, the Soo Line was forced into routing its westbound grain movements via Canada. I know of nothing specifically in the Staggers Act which would justify this type of behavior on the part of the large U.S. railroads. Nevertheless, the Interstate Commerce Commission has decided that it does not wish to intervene in this issue. A problem which will only grow more serious as the large transcontinental railroads battle the small regional roads. This area deserves Congressional attention.

Recently, the Interstate Commerce Commission proposed deregulating rail movement of nearly all agricultural commodities, with the exception of wheat, barley, soybeans and corn. Sunflower was originally included under the deregulation proposal but through efforts of many parties in the Upper Midwest, the Interstate Commerce Commission decided not to deregulate rail sunflower movements but has deregulated the other agricultural commodities included in the original proposal.

The North Dakota State Wheat Commission is very concerned that at some future date the Interstate Commerce or some other party may again try to deregulate rail movements of all agricultural products, including wheat. We strongly urge Congress to pass legislation making it clear that any further rail transportation deregulation should occur, if at all, at the will of Congress, and not at the whim of some regulatory agency bent on self-destruction.

North Dakota is a small rural state. Often, we wonder whether or not anyone in Washington, D.C., is listening to our concerns. For as long as we have been a state, we have been concerned about railroad freight rates and service. Passage of the Staggers Rail Act really does nothing to alleviate those fears. The North Dakota farmer remains one of the most captive and often most abused rail shipper in the country.

The North Dakota Wheat Commission urges Congress to take a second look at the Staggers Rail Act of 1980. Thus far, interpretation of the Act has been entirely one sided. We need a strong and impartial Interstate Commerce Commission, not one that has appeared to have sold its soul to the railroad industry. Additional legislation, in the areas mentioned, will be necessary to put the ICC back on track and heading in the right direction.

STATEMENT OF WILLIAM C. O'CONNOR, STAFF VICE PRESIDENT, KIMBERLY-CLARK CORP.

My name is William C. O'Connor. I am Staff Vice President for Kimberly-Clark Corporation and am responsible for transportation matters affecting Kimberly-Clark's domestic production and distribution facilities. The purpose of my statement is to express Kimberly-Clark's support for the Staggers Rail Act of 1980 and to urge Congress to be cautious in imposing any legislative changes that might undermine the beneficial results that have occurred thus far under the 1980 Act.

I. GENERAL DESCRIPTION OF KIMBERLY-CLARK CORPORATION

Kimberly-Clark Corporation manufactures fiber-based products for personal care and other diverse markets in many parts of the world. The Corporation's products are grouped into three major classes: Consumer and Service; Newsprint, Pulp and Forest Products; and Paper and Specialities.

Kimberly-Clark's 1982 net sales were in excess of $2.9 billion. It maintains 30 production and distribution facilities in the continental United States. Most of these production and distribution facilities are located on Class I railroads, but some of its facilities are exclusively served by short line railroads. In addition, Kimberly-Clark has some facilities that are "captive," i.e., facilities over which railroads have market dominance. Kimberly-Clark is a substantial user of rail service for both receipt of raw materials and for shipments of finished products.

II. EFFECT OF THE STAGGERS RAIL ACT ON KIMBERLY-CLARK

Kimberly-Clark generally supports the reduction in the role of government in business. Moreover, we believe government regulation of the relationship between shippers and railroads should be minimal. It is Kimberly-Clark's experience that motor carriers often provide a viable competitive alternative for shippers. When such competition is available, the Staggers Rail Act works effectively and as planned by Congress. Since the passage of the Act, railroads have become more sensitive to competition, more responsive to market conditions, and more innovative in their approach to the transportation problems of shippers.

One demonstration or measure of the responsiveness of railroads to market conditions is their share of Kimberly-Clark's transportation movements of consumer products since the passage of the Staggers Rail Act compared with the railroads' share prior to the Act. In 1974 railroads moved 70 percent of Kimberly-Clark's consumer products in the United States. Motor carriers moved the other 30 percent. The railroads' share gradually eroded until by 1980 the market positions of the two modes were reversed; railroads moved only 30 percent while motor carriers moved 70 percent. Since 1981, however, railroads have retained their share of Kimberly-Clark's transportation.

The ability of railroads to prevent further erosion of their market share since 1981 may be attributable to a number of factors, but the competitive environment created by Staggers Rail Act is a major one. Initially the railroads were hesitant and confused in a deregulated environment. As a result, the true benefits from the Staggers Act were not immediately apparent. Now, however, railroads approach Kimberly-Clark with innovative proposals to keep traffic moving via rail. Railroad personnel became more aware of their own cost elements and have demonstrated they can effectively participate in competitive markets. In short, railroads have become conscious of the competitive environment and have reacted with innovative pricing.

The Staggers Rail Act also has provided a healthy incentive for Kimberly-Clark to seek opportunities for shipments via alternative modes. Prior to the Staggers Rail Act, most shippers perceived that many shipping points were captive to particular railroads. Kimberly-Clark is now more inclined to evaluate its loading and unloading practices and distribution procedures to accommodate alternative modes and establish a competitive climate. In such cases, rail carriers have been more receptive to meeting competition. In many situations, the new procedures for dealing in a less regulated environment have not been easy for railroads or shippers, but overall the changes have benefited Kimberly-Clark and, we believe, are healthy for the United States transportation system.

One significant provision of the Staggers Act permits shippers and railroads to enter into contracts. Since passage of Section 208 of the Act, Kimberly-Clark has entered into nearly twenty contracts with various railroads to meet special distribution requirements. The contracts have been structured to provide incentives for railroads to improve their efficiency and for the most part have been successful. Contracts have been successful in part because railroads and shippers can identify special needs and design custom-styled provisions to meet these needs. Confidential treatment of these contract provisions has encouraged innovation by shippers and railroads.

III. RECOMMENDED ROLE OF CONGRESS

Kimberly-Clark is concerned about a potential "backlash" by some segments of the transportation industry in response to recent decisions by the Interstate Commerce Commission ("ICC"). We fear that Chairman Taylor may have been correct in his dissent in Ex Parte 346 (Sub-No. 8), Exemption from Regulation—Boxcar Traffic, that the boxcar deregulation decision may result in reregulation. See Ex Parte 346 (Sub-No. 8) at 45 (served May 2, 1983). We urge Congress not to reregulate. While certain aspects of the boxcar deregulation decision give Kimberly-Clark concern, we believe that the ICC and the courts should complete their pending review of the decision before Congress acts. In any case, the ICC decision does not justify amending Section 213 of the Staggers Rail Act to remove the ICC's exemption authority. The exemption authority is needed to permit the ICC to respond in appropriate cases when areas of transportation can be deregulated.

It is premature for Congress to initiate legislation to amend the Staggers Rail Act. Shippers and railroads are still learning to live in a deregulated environment. For Congress to amend the Staggers Act so soon after its passage could have an inhibiting effect and stifle the innovative processes that have recently begun reshaping the relationships between shippers and railroads. The ICC decision in Ex Parte No. 346 (Sub-No. 8), Exemption from Regulation—Boxcar Traffic, and the recent decision by the ICC to deny the petition by the National Industrial transportation League in Ex Parte No. 445, Standards for Intramodal Rail Competition, have not been conclusively resolved. Both are subject to judicial appeal or administrtive reconsideration in some form. Moreover, amendments to the Staggers Act at this time are not appropriate in light of improving economic conditions. The Staggers Act has not been tested with the transportation system operating at full capacity. The recent excess transportation capacity has not provided a fair and complete measure of the economic and market responsiveness of carriers. The effectiveness of the Staggers Act under favorable economic conditions is more likely to provide better information about how the Act might be improved.

Kimberly-Clark also is concerned about suggestions from some witnesses during recent Subcommittee hearings for amending Section 208 of the Staggers Rail Act to require parties to publish economic and other details of rail contracts. Contracts between shippers and railroads often contain sensitive business information, such as projected tonnages, that parties should not be forced to reveal. Government-forced disclosure is exactly the type of interference that would inhibit the innovative quality of contracts. While in any business it is comforting to know what the competition is paying, most business is successfully conducted without such knowledge.

IV. CONCLUSION

In conclusion, Kimberly-Clark believes that the benefits that have arisen since the passage of the Staggers Rail Act of 1980 have fostered a competitive environment that has been beneficial to shippers and railroads. These benefits outweigh the uncertainties generated by some recent Interstate Commece Commission decisions. Congress should continue monitoring the ICC and express its displeasure to ICC Commissioners whenever the ICC does not abide by the spirit of the Staggers Rail Act. Nevertheless, we urge that changes to the Staggers Rail Act, if any, not go so far as to inhibit the benefits that shippers and railroads have enjoyed under the Act.

STATEMENT OF PLATTE RIVER POWER AUTHORITY

My name is Albert J. Hamilton. I am general manager and chief executive officer of Platte River Power Authority ("Platte River"). In that capacity, I am responsible for the planning, organization, staffing, direction and coordination of all of Platte River's operations, for recommendations of policies and programs to its Board of Directors, and for the construction of its facilities. I was graduated from the University of California in 1939, with a B.A. degree in economics, and except for combat service during World War II, I have been continuously employed in the public utility business and related consulting work since graduation.

The purpose of this statement is to express Platte River's support for amendments to the Staggers Rail Act of 1980 ("Staggers Act") to insure much needed protection for captive shippers and to bring improvement in the manner in which the Interstate Commerce Commission ("ICC") has implemented the provisions of the Staggers Act.

Platte River is a separate governmental entity, and a political subdivision of the State of Colorado. It was formed in 1973 by four municipalities in Colorado to construct, operate and maintain generating plants, transmission systems and related facilities for the purpose of delivering to the municipalities electric energy for distribution and resale. The four municipalities are Estes Park, Fort Collins, Longmont and Loveland. The general offices of Platte River are located in Fort Collins, Colorado.

Platte River is completing the final construction and start-up phase of a coal-fired 250 megawatt Rawhide generating plant which is located approximately 20 miles north of Fort Collins. To supply fuel for Rawhide, Platte River in 1978 entered into a long term coal supply agreement with a producer in the southern Powder River Basin of Wyoming. The contract provides for a long term supply of compliance coal for fuel for the plant. Rawhide is scheduled to begin commercial operation sometime during 1984.

The selection of, and commitment to use, the Rawhide site for the construction of a power plant, and the decision to purchase coal from the southern Powder River Basin, was determined, in large part, on the availability of an economical rail transportation system between the mine and the plant. Each year during the estimated 35 year life of the Rawhide generating plant, approximately 900,000 tons of low sulfur coal will be burned. As a result of Platte River's responsibility to serve the energy needs of its customers, and as a result of entering into a long term coal supply agreement, Platte River finds itself a captive shipper to a western railroad, the Burlington Northern Railroad Company ("Burlington Northern").

The Congressional statement of rail transportation policy, which appears in § 10101 of the Staggers Act, has been used by the ICC and the railroad industry to take unfair economic advantage of captive utility coal shippers such as Platte River. The policy to allow the "demand for services" to impact the establishment of reasonable rates for rail transportation may be a viable concept, where there are competing transportation modes for the same business. However, where, as in the case of Platte River, there is no competition for the services offered by the Burlington Northern, the "demand for services" concept of "demand pricing" should not be the standard for the establishment of reasonable rates.

The ICC in Ex Parte No. 347 (Sub-No. 1) Coal Rate Guidelines—Nationwide, proposes to determine the reasonableness of coal rates based upon "demand pricing," limited only by the costs to a shipper to provide the rail transportation services itself. In addition, the ICC proposes to allow railroads to increase their rates up to 15 percent per year with a presumption that the higher rates will be reasonable. The ICC has stated it will not, on its own initiative, investigate such rates.

The ICC makes it clear that it does not intend to provide any significant regulatory protection for captive shippers. As a result, Platte river supports the proposal in H.R. 2584 which seeks to amend § 10101a(1) of Title 49, U.S.C. by striking out the words, "and the demand for services" and inserting in lieu thereof, "among carriers to provide transportation services." Platte River likewise supports H.R. 2584's proposal to amend § 10101a(6) of such title to read as follows: "To maintain reasonable rates where there is an absence to effective competition as defined in § 10709(a)."

The ICC in Ex Parte 347 (Sub-No. 1) has attempted to intertwine the concept of railroad revenue adequacy and protecting or not protecting captive shippers. The ICC has come down on the side of the railroads. Ex Parte 347 proposes that until railroads are revenue adequate, as defined and determined by the ICC, railroads shall have virtually a free hand in determining what they will charge their captive traffic. It is clear that the ICC has intended to make the railroad industry revenue adequate by making captive shippers bear a disproportionate share of the costs to reach the goal of revenue adequacy.

Platte River is willing to pay a reasonable rate in return for reliable rail transportation services. However, Platte River is not the reason why the rail industry is not revenue adequate. The ICC has seemed almost zealous in its efforts to provide no regulation for captive traffic while encouraging the railroads to provide very competitive rates where there are competing modes of transportation.

Section 208 of the Staggers Act provides that common carriers and users of transportation services may enter into contracts covering such transportation services. The railroad industry has used § 208 in an attempt to argue that the decision to contract or not contract is sufficient protection for a utility if it wishes to avoid becoming a captive shipper. It assumes that a utility can avoid making rail-related investments which would, as a practical matter, cause the utility to become a captive shipper. The ICC has apparently agreed with these specious arguments advanced by the railroad industry. In actual fact, most utilities have no choice.

In Ex Parte 320 (Sub-No. 2), Market Dominance Determinations and Consideration of Product Competition, the ICC announced that it would give little evidentiary value to coal supply agreements entered into before a certain date. The ICC reasoned that because a utility was free to enter into a rail transportation contract, it should never contract for a coal supply without having, previously or concurrently, secured a rail contract. Again, the ICC misses the point. Without real competition, the right to contract for rail service is meaningless. A captive shipper has no bargaining position with the railroad and thus cannot achieve reasonable terms through the give and take of bargaining that is normally associated with competitive circumstances.

In other words, the railroad knows that a captive utility has no transportation alternative. As a result, a "take it or leave it" Hobson's choice is often the only thing offered by the railroad.

In addition, Ex Parte No. 320 also announced the ICC's intention to continue to include geographic and product competition as evidence to be considered in market dominance determinations. The ICC did this, notwithstanding the clear language of the Staggers Act which indicates that such factors should not be considered in the determination of market dominance and notwithstanding the clear definition of market dominance contained in the Staggers Act which precludes the concept of geographic and product competition.

In consideration of the above, Platte River supports the provisions of H.R. 2584 which would amend § 10709 of the Staggers Act by adding the following: "(e) In determining the existence or absence of effective competition for purposes of this section, the Commission shall consider only transportation competition for movement of the same commodity from the same point of origin to the same destination."

The railroads have indicated their desire to remain free of regulation and have argued strongly for the implementation of complete deregulation of the industry. Platte River believes that the railroad industry should never be free from regulatory restraint until Congress insures that there is actual and viable transportation competition available to every shipper in the land. At such point, true competition would supplant the necessity of having artificial restraints placed on the railroads through a regulatory agency.

In order to achieve a true competitive stature which would justify a complete deregulation of the rail industry, Congress should consider legislation which would allow every railroad, which desired to provide service to a particular shipper, access to that shipper regardless of the ownership of the tracks between the shipper's points of origin and destination. In other words, Congress should provide for mandatory trackage rights to all railroads which desire to provide transportation services. Such legislation should also address the schedule of users fees which the user railroad would have to pay to the railroad owning the tracks. Legislation should provide that if an agreement could not be reached between the railroads, then the ICC would have the authority to make the determination.

Mandatory trackage rights legislation would be necessary to require the ICC to determine user fees among or between railroads. In Ex Parte 347, referred to above, the ICC decided on July 14, 1983, that the Interstate Commerce Act does not allow or provide authority to the ICC to compel one railroad to grant trackage rights over its lines to another carrier. Legislation enacted upon the principles just discussed would help insure that utilities, such as Platte River, would, in fact, have a transportation alternative as opposed to the present hypothetical, unsubstantiated, and arbitrary theories of "artificial competition" as announced by the ICC in Ex Parte 347.

True competition would pave the way for true deregulation, something the railroad industry says it wants. Platte River supports such deregulation if it is facilitated by adequate legislation providing mandatory trackage rights and ICC determined user fees.

STATEMENT OF THE RAILWAY PROGRESS INSTITUTE'S COMMITTEE ON EQUIPMENT LEASING

The Railway Progress Institute (RPI) is the national association of the railroad and rail rapid transit equipment and supply industry. Its membership includes the vast majority of the companies which supply railroads and rail rapid transit systems with rolling stock and components, signal systems, rail and track materials, and maintenance-of-way equipment. In short, everything that goes into making a railroad system.

Its Committee on Equipment Leasing is made up of representatives of companies that lease freight cars and intermodal trailers and containers to railroads and shippers. The companies represented on the Committee own almost 500,000 pieces of such equipment.

This statement is being filed on behalf of the RPI Committee on Equipment Leasing. While the Committee supports the general concept of railroad deregulation, we would like to highlight two areas of concern to us, TOFC/COFC deregulation and boxcar deregulation.

I. TOFC/COFC DEREGULATION

Lessors of intermodal trailers as a group represent approximately 90,000 trailers of a 140,000 total population, or about 65 percent of the total. Based upon this capital investment, one would presume a desire on the part of the railroads to insure a reasonable working relationship. While the need for such a relationship has been the posture of most lessors, the railroads have not responded in kind.

The efforts of the railroads since the ICC decision in Ex Parte 230, Sub. 5, have been to use deregulation to:

1. Permit the voiding of all existing contractual arrangements regarding the conditions of use and payment of equipment;
2. Reduce rates paid for the rental of lessor-provided equipment;
3. Alter the contractual relationships of other railroads with lessors;
4. Force lessors to lease equipment only to railroads to the exclusion of other potential lessees; and
5. Pick from among the AAR Car Services and Interchange Rules those that are of benefit to the railroads alone.

Voiding of contractual arrangements

The Ex Parte 230, Sub. 5, decision was seized by the railroads as an opportunity to invalidate existing leasing arrangements under the guise of "antitrust." They voiced concern over the "uniformity" of such agreements and declared that such uniformity was de facto an antitrust violation.

In many cases, this has resulted in: 1. Cancellation of agreements; 2. Refusal to honor changes in terms and conditions as prescribed by the lessor; and 3. Unilateral replacement of a lessor's agreement by one developed by the railroad.

All of the above have jeopardized the basis for the leasing industry's investment in the industry and its ability to make a reasonable return on its assets. In addition, significant management time has been spent to repair the working relationships created by such business behavior.

Reduction of rental rates

Many railroads took immediate action to reduce rates which we previously established in one of two forms: 1. AAR Interchange Rate; or 2. National Railroad Trailer Pool Rates.

Lessors are at a severe disadvantage if a railroad has declared an agreement null and void (whether or not that is a valid legal position) but is able to use the leasing company equipment anyway due to the interchange nature of the U.S. railway system. Such conditions lead to extreme leverage used by the railroad to reduce the price for its use of that equipment.

Railroads maintain that leasing company rates are too high despite the fact that it is acknowledged that the AAR Interchange Rate was set only to cover cost. Lessors have a profit motive and must price their products accordingly.

The "rate squeeze" manifested itself in several forms: 1. Refusal to acknowledge higher levels of service required by the railroads and the risk of obsolescence; 2. Requirement to place equipment in an off line status when not loaded (on relief); and 3. Assessment of charges for storage when equipment is idle and in the railroad's possession.

Alteration of contracts

Many railroads went even further. They proceeded to define for lessors what they could and could not do with other lessees.

The most significant occurrence here was the refusal to pay a lessor for the use of a trailer bearing a hybrid (joint railroad and lessor) mark, despite authorization of the lessee to make payment in that fashion. This placed the lessee in violation of its agreement with the lessor, created a potential credit problem for the leasing company, and imposed upon the lessee a requirement to develop car hire accounting systems which it did not have nor did it want.

Railroads only as lessees

The railroads have taken the position that they are the only lessees of intermodal trailers. The fact is that railroads both own and lease and, hence, are at the same time a user and competitor of the leasing company. Competition is for the load, however.

A free market demands that shippers and users of equipment have freedom of selection.The use of their dominance as the major link in a rail intermodal movement results in the railroad's ability to pressure other lessees to avoid the use of a given lessor's equipment.

In reality railroads are not nor can they be the only lessee of equipment.

Rule applicability

Finally, despite their ability to collectively establish rules of interchange and service, the railroads in many cases have selected only those which benefit them as a user and have refused to acknowledge those which impose responsibilities on the user.

Summary

All of these actions are an abuse of the system. A free market can be and has been of significant value to shippers, carriers, and lessors alike. However, irrational behavior as noted above can result in: 1. Disincentives to future investment; 2. Decommitment from development of new products and services; 3. Deterioration of working relationships which create new transportation opportunities; and 4. Unprofitable operations for all participants in the intermodal movement.

Deregulation must be viewed only as an opportunity to enhance intermodalism by rail, motor, and water. It can only be an opportunity if: 1. The interchange system which has been developed over the years remains intact and predictable for its users; 2. Intermodalism is recognized to have multiple participants who share equally in the transportation service; and 3. The lessor/lessee relationship remains intact as one mutually beneficial and not unilaterally favorable.

II. BOXCAR DEREGULATION

Our Committee has followed the progress of boxcar deregulation from its beginning with the initial Petition of Conrail for Exemption filed on May 21, 1981. As a result of consideration of the matter, a resolution was adopted in opposition to the granting of boxcar exemptions proposed by Conrail. While the ICC has in fact ruled in this matter, we feel the points mentioned in our resolution are still valid. A copy of the resolution (Exhibit 1) is attached.

A primary concern of RPI, which is reflected in the resolution, is that the exemption will substantially limit the rights of a car owner, place control over boxcar use and rental rates in the users of such equipment rather than in owners or a public body and, thus, discourage rail carriers from acquiring additional equipment to meet the nation's need. This will not promote the national transportation policy, will not be in the public interest, and, of course, will be directly contrary to the interests of the RPI Committee on Equipment Leasing.

The decision reached by the Commission is designed to nullify current rights of the car owner by authorizing the user to assess charges for moving empty boxcars and authorizing the user to hold an owner's cars indefinitely without paying car rental after the first 72 hours. Investors are going to be unwilling to buy new boxcars in such circumstances where the owner has no control over his investment except to pay the user (who benefitted from the loaded move) to send it back.

The ICC decision is not consistent with the National Rail Transportation Policy (49 U.S.C. § 10101a) since it would not promote an efficient rail transportation system adequate to meet the needs of the public and the national defense. Moreover, it would clearly work against the Congressional mandate in 49 U.S.C. § 11122 that the Commission "shall encourage the purchase, acquisition, and efficient use of freight cars." That section of the Act was the subject of proposed amendments during development of the Staggers Rail Act, and Congress decided not to alter it.

III. CONCLUSION

At the outset we stated our support for the concept of railroad deregulation as authorized by the Congress. We did feel it necessary to bring to the Subcommittee's attention two areas of concern to the RPI Committee on Equipment Leasing in which the ICC may have decided beyond the letter and spirit of the law.

EXHIBIT I.—RESOLUTION ON BOX CAR DEREGULATION

Whereas, the ICC on January 26, 1982, issued a Notice of Proposed Exemption on boc car traffic under Ex Parte No. 346 (Sub. No. 8) in answer to a petition filed by Conrail several months ago to exempt all box car traffic moving to, from, or via Conrail.

Whereas, the Commission is now asking comments not only on exempting box car traffic moving via Conrail but also on exempting all box car movements by all railroads from some or all ICC regulations.

While maintaining strict neutrality on the exemption, the Commission does state it may issue a decision on the Conrail exemption before a decision is reached on the question of a general box car exemption.

Whereas, Congress through legislation has required the ICC to determine and publish car hire rates that would provide owners of freight cars with a return on the current cost of ownership including the current cost of capital. Exempting car hire charges will allow Conrail and possibly any railroad to pay the car owner any rate whether compensatory or not and to misuse, hold, delay, or commandeer cars for their own purpose without any satisfactory and prompt way for the owner to obtain redress.

Whereas, Conrail, through past action, has made it quite clear what it would like to do about box car traffic. It has imposed surcharges on some box car traffic and cancelled large numbers of joint rates and routes over which other box car traffic has moved. This philosophy could easily spread to other carriers handling a large volume of box car traffic but not owning a sufficient number of box cars to protect shippers' requirements.

Whereas, exemptions such as requested by Conrail could divert much of the box car traffic to other modes and would discourage any carrier from acquiring this or any type of equipment for which the user can dictate the price it would pay for its use or, in fact, misuse.

Furthermore, no careful investor is going to be willing to purchase new box cars over which he will have so little control. The consequences of less trafic and an insecure investment will be extremely adverse for the car builders.

Whereas, exemption of car hire and car service from regulation would disrupt orderly interchange among carriers. Carriers interested in promoting a smooth-running, national rail system adequate to meet the demands of our nation's commerce and of our national defense should oppose such exemption.

A-car owner who invests in equipment which is not subject to his day-to-day use and control, as in the national regulated network, is entitled to receive payment from those who use the cars in an amount that would return equitably the current costs during the period of such use. Regulation of car hire and car service assures this result.

Whereas, the RPI advocates and supports the newly stated Rail Transportation Policy of the United States Government as stated in the Staggers act, including the policy:

(1) to ensure the development and continuation of a sound rail transportation system with effective competition among rail carriers and with other modes, to meet the needs of the public and the national defense;

(2) to maintain reasonable rates where there is an absence of effective competition and where rail rates provide revenues which exceed the amount necessary to maintain the rail system and to attract capital; and

(3) to prohibit predatory pricing and practices, to avoid undue concentrations of market power and to prohibit unlawful discrimination.

Therefore, be it resolved that RPI being consistent with its objectives and purposes and vitally interested in continuation of an efficiently operating national railroad system opposes the granting of these exemptions.

STATEMENT OF JOHN REALE, VICE PRESIDENT—TRAFFIC, PITTSBURG & SHAWMUT RAILROAD

Mr. Chairman and members of the Committee, my name is John Reale. I am Vice President—Traffic for The Pittsburg and Shawmut Railroad Company. I appreciate this opportunity to submit a statement to the Committee on the subject of boxcar deregulation.

The P&S Railraod is a Class III carrier located in Western Pennsylvania in the counties of Armstrong and Jefferson. It has 100 miles of track and 130 employees. We are not a bridge carrier, that is all traffic must either originate or terminate on this line. Two rail connections, the B&O at Dellwood and West Mosgrove and Conrail at Brookville and Freeport, allow our shippers to move their product beyond our line.

We oppose the recent ICC ruling on boxcar deregulation and would urge you to do whatever you can to reverse that ruling.

Let me say from the outset, I am not here as part of some larger effort to reregulate the rail industry. Indeed, the P&S supported passage of the Staggers Act in 1980. Nor am I here because the ruling will have any immediate impact on our fleet of cars. The P&S does not own any boxcars. Rather, I believe the recent ICC ruling is bad public policy which breaks faith with the original intent of the Staggers Act, and which will seriously affect the health of a significant portion of the rail industry. Even more important, if permitted to take effect, it will lead to the same treatment of other types of cars, thereby spreading the negative economic effects to an ever increasing portion of the industry.

My arguments are fourfold:

First, the ruling is not deregulation, it is simply the substitution of one regulation for another. Rather than regulating the movement of the car from the owner at point A to the user at point B, it merely reverses the regulation, through the 35-cent/mile return charge, applying it from B back to A. In so doing, it transfers control of the boxcar from the investor and owner to the user, a situation which not only decreases operating revenues for the owning railroad as a whole, but threatens the underlying equipment trust certificates which were issued to provide the financing of the cars in the first place. Deregulating the industry so as to allow carriers to achieve revenue adequacy was a primary purpose of the Staggers Act. This shift in regulation merely provides revenue adequacy for one segment of the industry at the expense of another segment, a consequence that was surely not intended by the authors of the Act.

I have heard a number of large railroads defend this ruling by claiming that the 35-cent/mile return charge is not a regulation per se, but a negotiable item. They insist that they need a strong shortline system to constantly feed them traffic and not wanting to discourage that traffic will probably never charge the 35-cent/mile return fee. It seems to me that defense begs the question. If this new regulation won't be used, why was it so eagerly sought in the first place? That defense is particularly hollow when offered by those railroads that are instituting proportional rates which substantially reduced the ability of the smaller railroads to compete in the marketplace.

Second, this ruling retroactively undermines the very rules that led to the financing, and or purchasing of thousands of boxcars in the first place. I am not speaking of the decision of railroads or leasing companies to build or buy boxcars and then fail to make a profit because demand declines. That is a risk any businessman takes in the marketplace. Rather, I am talking about the elimination of the rules that were established to provide the incentive for that investment in the first place. Those rules—the Investment Tax Credit, Accelerated Depreciation and user fees—were established to guarantee the financing of the debt that built the boxcars. The ICC ruling eliminates one of those rules, thus severely jeopardizing that financing by fiat. I dare say this Congress would never retroactively eliminate the Investment Tax Credit or Accelerated Depreciation on a business investment that had already been made under those rules. Yet that is exactly the affect of this ruling by the ICC.

Third, I believe this decision will threaten the continuation of the current level of rail service in many regions of the country. Under the new ruling, a user can, after three days, store a boxcar on its line for an indefinite period, returning it to the owner only upon request and at a charge of 35-cent/mile for an empty car. The result will be a delay in the return of boxcars, as the owners wait for a return shipment to avoid the 35-cent/mile charge—a wait that is lengthened by the fact that the user will fill any of his own boxcars first. As I indicated, the P&S does not own any boxcars. However, we do receive and ship boxcar traffic. Since we rely on our connections to deliver loaded boxcar traffic to us and also to supply us with empty boxcars for loading, any delay in the return of the boxcar will result in the loss of traffic to the P&S. Efficient and timely service is one of the most important tools we have to compete not only with larger railroads, but also with trucks. This ruling jeopardizes this tool in a most significant manner.

Fourth, I believe if this ruling is allowed to stand, it will inevitably lead to similar rulings on other types of cars. If this comes to pass, the P&S, which owns 1,300 open top hopper cars would be seriously affected. Let me give you two real life examples of how a similar ruling on hoppers would affect our revenue picture.

We ship coal to Ravena, New York. The car goes 30 miles on the P&S and 300 miles on another railroad. The net weight of each car is approximately 93 tons and we receive $3.46 net ton for our portion of the haul for a total revenue to the P&S of

$321.78/car. Our costs run at a minimum of $2.80 net ton for a total cost of $260.40/car. If we must pay 35 cents per mile to return this car 30 miles from Ravena, New York, this will result in a deficit to the P&S of $43.62/car for the movement. We also ship coal to Rochester, New York. The car moves 30 miles on the P&S and 160 on another railroad. We receive $3.49 net ton for our portion of the haul for a total revenues to the P&S of $324.57/car. Our costs are at a minimum of $2.80 net ton for a total cost of $260.40/car. If we must pay 35 cents per mile to return this car 160 miles from Rochester, New York, our revenue per car is reduced to $64.00. In addition to the loss incurred by the application of the 35 cents per mile charge, after 72 hours we would also lose the car hire which would normally occur on the car, if it were permitted to move back to the owner under normal movement.

In discussing this ruling during your hearings one ICC Commissioner stated that shortline railroads may have reason to be concerned in the shortrun. As you can see from these numbers, which I am sure can be cited by the majority of shortline railroads that own boxcars, the Commissioner's statement is most assuredly an understatement. Indeed the short run may be so devasting that we won't be in business to test the effect over the long haul.

In summary, Mr. Chairman and members of the Committee, I believe that Congress should do whatever is necessary to reverse this ruling. It does not provide deregulation as envisioned under the Staggers Act. It retroactively undermines rules that were created to provide incentive for a specific investment. It will jeopardize service in many regions of the country. It threatens the financial viability of this nation's shortline railroads.

Again, I appreciate the opportunity to present my views to the members of the Committee, and hope that they are in some way helpful as you review this important matter.

STATEMENT OF WALTER RICH, PRESIDENT AND CHIEF EXECUTIVE, DELAWARE OTSEGO RAIL SYSTEM

Mr. Chairman and members of the Committee, my name is Water Rich, and I am President and Chief Executive Officer of the Delaware Otsego Rail System. We are a Class III railroad owning some 450 miles of track in New York, New Jersey and Pennsylvania. We currently employ 150 people. I appreciate the opportunity to present a statement in support of the ICC's ruling on boxcar deregulation.

As you well know, this decision by the ICC has generated a great deal of controversy. Its opponents have been particularly vociferous in their opposition, using both these hearings and a variety of other forums to attempt to reverse this ruling. I believe they are building their case on three myths—myths that, because of the frequency with which they are being repeated, I fear may be gaining some acceptance in Washington. I present this statement to you today as President of a small railroad to say that is exactly what they are—myths, and that in the real world of operating railroads, this decision is a sound one and it should be allowed to stand.

Myth number one is that this ruling goes far beyond anything ever envisioned by the Staggers Act. To quote ICC Chairman Reese Taylor, himself an opponent of the boxcar decision: "The Act was intended to assist the rail system to remain viable in the private sector of the economy and to allow railroads to compete effectively among themselves and with other modes of transportation."

This is precisely the goal achieved by the boxcar decision.

Railroads have been losing boxcar traffic, due both to a general decline in traffic caused by the recession and to increased competition from trucks. The market is changing and we cannot change with it. Currently, if I want to lower a rate to attract a customer, I must file a 10 day notice with the ICC. More often than not, by the time it is approved, I have already lost the business to a truck. This new ruling gives us the freedom to react to the marketplace on a daily basis and that is the only way we can, as Chairman Taylor says, "compete effectively among ourselves and with other modes of transportation." I believe the result of the deregulation of fresh fruit and vegetables provides ample evidence as to what happens when railroads can price the product in the marketplace. In this instance, railroads are providing meaningful price competition with other modes of transportation, and are capturing a share of a market they never had before.

Myth number 2 is that this ruling is going to put small railroads out of business. As President of a small railroad, I believe I can say with some authority that this ruling is good for small railroads.

The Delaware Otsego has just concluded an agreement with Conrail, which will allow us to set our own rates on all boxcar traffic to Conrail destinations as long as we cover everyone's agreed upon minimums. That means our salesmen can go to a potential customer and have the flexibility to react to current market conditions and to compete on the spot with whatever offer has been made by trucks. If railroads are to survive in the private sector, they have to be given the opportunity to operate like private business. That is what this ruling does and that is good for small railroads as well as large.

There is also an important ancillary benefit to our agreement with Conrail, and that is that I am confident that with this new flexibility to react to the marketplace, we will reload nearly 100 percent of our inbound boxcars. Empty movement has been a chronic problem for the industry as a whole, and any improvements in this area will be good for the industry as a whole.

Myth number 3 is that this ruling is somehow bad for shippers and ultimately for the consumer. Nothing could be farther from the truth. How can a shipper be hurt by a railroad that is now able to provide meaningful price competition with trucks? And how can consumers be hurt when they are the beneficiary of price competition between alternate modes of transportation? The obvious answer is they have nothing to lose and may ultimately pay less for the delivered product.

Mr. Chairman, and members of the Committee, deregulation is here to stay. The Staggers Act has been tested in the toughest of economic times and the overwhelming majority of those affected by it agree that it has been, and will be, good for the railroad industry. The goal today should not be to try and turn back the clock, but rather to get on with the job of deregulation. Nothing can be more central to that task than allowing railroads to compete freely in the marketplace. That is exactly what is accomplished by this ICC decision.

There are those that argue that the boxcar is now going the way of the stage coach and the canal boat. I have been in the railroad business about twenty years and all during that time I have watched boxcar traffic disappear as truckers have become more and more competitive. It is human nature to prefer to operate under established rules rather than to chart a bold new course, the results of which are unknown. I submit, however, that the example of the last twenty years proves beyond a doubt that we will lose the boxcar traffic if we do not drastically change the way we do business. We must have the ability to react quickly in the marketplace. The cost of our equipment should be governed by supply and demand just like it is in any private business, including trucking. Even if we deregulate, the battle for boxcar traffic is far from won. It will be an uphill stuggle, but one that all those who have faith in the steel wheel or the steel rail demand be made. As Lord Sheldon said to the House of Lords, "It is better to die in battle than to perish by one's own hand in bed."

Again, I appreciate the opportunity to present my views to the Committee.

STATEMENT OF GLENN R. SCHLEEDE, PRESIDENT, NEW ENGLAND ENERGY INC.[1]

Mr. Chairman and Members of the Subcommittee: My name is Glenn Schleede. I work for the New England Electric System (NEES), which provides electricity to customers in more than one million homes, businesses, and institutions in Massachusetts, Rhode Island, and New Hampshire. In addition, NEES' generating units are part of the New England Power Pool (NEPOOL) and thus help provide electricity for customers in other areas of New England when needed.

We want to commend the Subcommittee for recognizing the serious problem of excessive rail rates and for holding hearings. We also want to thank you for this opportunity to present pertinent information and views.

Briefly, the comments that follow: 1. Explain why excessive rail rates are an important problem for the people of New England; 2. Describe the specific problems now needing the attention of Congress; 3. Identify the underlying causes of excessive rail rates; and 4. Outline actions needed to correct the problems.

The comments are limited largely to the problem of excessive rates charged for hauling coal. However, we understand that railroads are also charging excessive rates for hauling other commodities and that others have or will describe these problems for you.

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[1] Fuel and transportation subsidiary of the New England Electric System (NEES), 25 Research Drive, Westborough, Mass. 01581.

I. EXCESSIVE RAIL RATES FOR TRANSPORTING COAL ARE AN IMPORTANT PROBLEM FOR THE PEOPLE OF NEW ENGLAND

Excessive railroad charges for transporting coal are now an important problem for the people of New England for two principal reasons:

A. *First, New England utilities have increased their use of coal as a principal means of reducing dependence on oil.*—NEES is one of several New England electric utilities that has increased the use of coal. In 1979, NEES relied on oil for 78 percent of the energy used to generate electricity. By converting six generating units from oil to coal, NEES has been able to reduce dependence on oil to 20 percent, and during 1983 will use coal for 55 percent of its energy needs. During 1983, NEES will use about 3.3 million tons of coal and avoid the use of nearly 14 million barrels of oil.

This switch from foreign oil to domestic coal has made an important contribution to the national goal of reducing excessive dependence on foreign oil and reducing the outflow of U.S. dollars and jobs.

Switching to coal has made it possible to reduce customers' electric rates. However, it is important to note that customers would get additional savings if railroads were not allowed to charge excessive rates for hauling coal. In fact, each extra dollar charged by the railroads is a dollar taken from the pockets of electric customers.

B. *Second, New Englanders have no choice but to rely on railroads to transport needed coal.*—NEES can obtain coal meeting requirements of its generating units from western Pennsylvania, West Virginia, and southwestern Virginia. Railroads are the only means available to transport this coal to East Coast ports so that it can be loaded on ships and barges and be brought to the generating plants in Massachusetts. NEES is captive to the railroads and has no practical alternative but to rely upon them.

Railroad charges are a significant part of the delivered cost of NEES' coal, currently accounting for about 23 percent of the total. Coal at the mine accounts for about 64 percent and water transport for about 13 percent of the total.

II. THERE ARE FOUR KEY PROBLEMS NEEDING ATTENTION BY THE CONGRESS

There are four key problems that warant the attention of the Congress:

A. *Rates now being charged captive shippers by railroads are excessive.*—As the Subcommittee is aware, current law does not provide clear standards for determining whether rates are reasonable. Instead, the Staggers Rail Act of 1980 grants broad discretion to railroads to set rates, subject to limited regulation by the Interstate Commerce Commission (ICC). That Staggers Act does set thresholds (currently 170 percent of variable costs) below which rates are automatically judged to be reasonable. The ICC cannot review rates below this level even if it wants to.

NEES has conducted extensive studies, with the support of a rail rate expert, to determine the relationship between the rates being charged by railroads and the costs to the railroads of transporting our coal. NEES knew that rates were high and were increasing rapdily. NEES wanted to know more and needed to know more to seek rate relief from the ICC under the very narrow window and difficult process (for shippers) provided by Section 229 of the Staggers Act.

NEES' rail cost consultants followed trains carrying our coal from loading points at mines to the dumping points at ports. Movements were determined and timed. This data, together with "Rail Form A" data submitted to the ICC by the railroads, provided the basis for calculating the relationship of revenue resulting from railroad rates to the railroads' variable cost and fully allocated cost of moving NEES' coal. The results are startling:

1. First, the studies confirmed that there is no economic justification for the 170 percent and other thresholds provided for in the Staggers Act. In fact, rates at 170 percent of variable costs would provide the railroads with a return on equity in excess of 30 percent, after taxes. Stated another way, rates at the current threshold of 170 percent provide railroads with 15 percent to 18 percent more revenue than is required to cover all costs, including an after-tax return on equity of 18.3 percent. This 15 percent to 18 percent represents either an excessive contribution to a railroad's profit or a contribution to the cost of shipping someone else's commodities.
2. Second, the studies demonstrate that rates currently being charged NEES by railroads: Are in excess of 225 percent of variable costs; Are all in exces of 189 percent of fully allocated costs; and Provide the railroads with a return on equity in excess of 55 percent, after taxes!

NEES' electric customers are now paying more than $41 million per year for transporting coal by rail. Conservatively, NEES' customers are being required to pay between $2 and $3 more per ton on average for shipping coal from Appalachia to East Coast ports than is justified by railroad costs, including a reasonable return on equity. This means that the railroads are taking $6.5 to $10 million per year more from our electric customers than is justified.

B. *Under existing law and existing and proposed ICC regulations, rates can become even more excessive.*—Under various regulations recently proposed by the ICC, railroads would be able to increase rates substantially and the task of demonstrating unreasonableness will be even more difficult.

Under existing law and regulations, shippers bear the burden of proving that railroads are "market dominant," and generally bear the burden of proving that rates are unreasonable. Even then, there is no assurance of reasonable rates if the railroad has not met the ICC's unrealistic standards for being "revenue adequate."

In one set of rules, for example, the ICC recently decided that railroad assets should be valued at replacement cost (i.e., inflated) rather than original cost. This unwarranted accounting change would have the effect of making railroad earnings appear inadequate.

In additional rules proposed recently, the ICC has prescribed standards for rate reasonableness that would permit railroads to increase rates by 15 percent per year plus inflation, thus virtually assuring that there will be no protection for captive shippers from the ICC. Criticisms of these proposed rules (Ex Parte 347) have been submitted by utilities, consumers, federal agencies, and others but there is yet no hint that the ICC will begin carrying out its responsibilities for protecting those who are subject to the railroads' monopoly powers.

C. *Many groups and objectives are adversely affected by excessive rail rates.*—Many groups and important national objections are adversely affected by excessive rail rates. For example:

1. As indicated earlier, the $2 to $3 per ton "penalty" now being charged by railroads, over and above costs and a reasonable return, costs NEES' customers an unwarranted $6.5 to $10 million per year. Through this "tax" our customers are contributing to unearned railroad profits or subsidizing someone else's rates. Other electric customers across the nation are also paying this hidden "tax".

2. The penalty from excessive rail rates increases the delivered cost of U.S. coal and reduces its competitiveness in domestic and foreign markets. This reduces the chances that the thousands of unemployed miners in coal-producing regions of the U.S. will be able to go back to work.

3. The reduced competitiveness of U.S. coal also affects coal producers. In current soft markets, it means that the potential sales are being lost or the railroad is capturing some margin that the producer should earn. It may even mean that the producer who is faced with competition (unlike the railroads) is selling coal below cost so as to stay in business while waiting for help from Congress.

4. To the citizens and businesses in coal-producing regions, the penalty resulting from excessive rail rates probably means less coal will be produced, less income will flow to the region, and there will be less of everything for the workers in the region.

5. Viewed from a broader national perspective, excessive rail rates for hauling coal interfere with a number of national objectives. For example:

The costs of products and services, particularly those dependent upon electricity and steel—both of which are heavily dependent on coal—will be higher in the U.S. and will be less competitive in foreign markets; and

High delivered costs of coal reduce the chances for economic conversion of additional existing utility and industrial plants from oil to coal. This means less opportunity to cut back on foreign oil imports and the outflow of U.S. dollars.

D. *Correcting the false impression that coal-hauling railroads are in poor financial health.*—One of the principal arguments for passing the Staggers Rail Act of 1980 was that railroads were not able to charge rates sufficient to provide the capital needed for maintaining and upgrading rights-of-way, roadbeds, trackage, and equipment. Under the Staggers Act, railroads have been able to reduce unnecessary costs by eliminating some uneconomic lines. Unfortunately, the Act also leaves room to raise revenues by charging high rates, particularly where the railroads enjoyed monopoly control.

Despite the substantially improved financial conditions of most coal-hauling railroads, the ICC has sought to preserve the image of poor financial health. In part, this has been done through unrealistic ICC standards for assessing a railroad's "revenue adequacy". The ICC's decision on replacement cost accounting—referred to earlier—is another outstanding example.

A review of the financial reports of principal coal-hauling railroads and assessments by financial analysts specializing in railroad securities makes clear that most coal-hauling railroads are not short of capital and, in fact, are in excellent financial health. Further evidence of strong financial health is provided by the growing number of acquisitions by railroads of large blocks of stock or of total control of other firms outside the rail industry. Such acquisitions have included major energy and natural resource companies and other transportation companies, including a barge line that has been a principal transporter of coal.

In short, poor financial health and the need for capital are not valid justifications for maintaining the railroads' freedom to charge excessive rates to captive shippers.

III. THERE ARE FOUR PRINCIPAL UNDERLYING CAUSES OF THE PROBLEM OF EXCESSIVE RAIL RATES

A. *Railroads have a monopoly over the movement of coal over land in many areas.*—As explained earlier, railroads provide the only practical way of transporting coal from Appalachian areas to coal users in the East. In fact, the National Coal Association has cited studies showing that 65 percent of all coal used in the U.S. is transported wholly or partially by rail and that 85 percent of this coal traffic is "captive," in that there are no practical transportation alternatives.

B. *There is no practical alternative to government rate regulation when there is an economic monopoly.*—Supporters of deregulation can properly claim that it has been a success in many situations over the past few years, including for railroads when competition exists. But even the most ardent supporters of deregulation do not claim that there is a practical, effective alternative to rate regulation when a monopoly exists. Unfortunately, this fact was not reflected in the Staggers Act of 1980 and has often been overlooked in the ensuing debate over rail rates.

Actually, some in the Congress at the time the Staggers Act was passed recognized the existence of monopoly conditions, particularly for coal shippers, but their hard-fought attempts to provide protection have not proven effective.

C. *The Staggers Act is conceptually flawed in its treatment of monopoly situations.*—There are at least three ways in which the Staggers Act is conceptually flawed with respect to protection for captive shippers:

1. The thresholds for ICC review of rate reasonableness (currently 170 percent of variable costs) simply are too high. As indicated earlier, rates at 170 percent of variable costs permit a railroad to earn in excess of 30 percent return on equity after taxes. Rates at the 170 percent level provide revenue 15 percent to 18 percent above fully allocated costs. Until these thresholds are removed, the ICC would not be able to give captive shippers the protection that is warranted—even if the ICC were inclined to do so.

2. Captive shippers generally bear the burden of proving "market dominance" and "unreasonableness" of rates reasonable access to information needed for proof.

3. The basic approach of the Staggers Act, in effect, has been to permit railroads to cut rates in those situations where competition from other transportation modes existed, without ICC review, and then to make up the difference or more by charging high rates to captive shippers. (The provisions included in the Act, which apparently were intended to limit "non-compensatory" rates, have not been implemented by the ICC.)

We should all recognize that there is no sound reason why consumers of commodities which are subject to "captive" conditions should bear the burden of uneconomic rail operations or low rates charged to others.

Instead of dealing with this basic problem, the ICC has seemed intent on encouraging an unproductive debate between ICC's economists and shippers' lawyers over how excessive demands upon captive shippers should be allocated among those shippers.

D. *The ICC, in exercising its authorities, has consistently favored railroads to the detriment of captive shippers and consumers.*—The ICC's role in rate regulation was clearly and intentionally reduced by the Staggers Act, but the ICC was left with authority that permitted some protection for captive shippers. Unfortunately, the ICC has repeatedly used its authority to ease the way for excessive rail rates. Examples include:

1. The ICC's definition of "revenue adequacy" which—despite the healthy condition of most coal-hauling railroads—has permitted most railroads to claim they are "revenue inadequate". This provides additional flexibility to charge high rates.

2. The ICC's attempt to broadly define "market dominance" suggested that effective competition was present, when such competition does not in fact exist.

3. The ICC has failed to enforce the provisions of the "Long-Cannon" amendment, which amendment was intended to limit or eliminate non-compensatory traffic.

4. The ICC has failed to require adequate cost and other financial information from railroads.

5. The ICC has adopted "rail cost adjustment" procedures which require upward rate adjustments when costs increase, but do not require downward adjustments when costs decrease as a result of productivity improvements.

IV. ACTION IS NOW NEEDED BY CONGRESS

Prompt action is needed by the Congress and the Administration to deal with the problem of excessive rail rates. Three particular actions are required:

A. *The Staggers Act should be amended to provide protection against unreasonable rates for captive shippers and their customers.*—More specifically, the Act should be amended to:

1. Establish reasonable costs (including a reasonable return on investment that is used and useful) as the sole standard for determining rates that may be charged. A cost-based standard has long been used to evaluate rates in other monopoly situations and it should be adopted for rail rates when shippers have no practical alternative to the use of railroads.
2. Eliminate the thresholds for ICC review of rate reasonableness (currently set at 170 percent and scheduled to be raised in October). Rates at 170 percent of variable costs provide excessive profits to railroads for hauling coal or unwarranted subsidies for rail transport of others' commodities.
3. Establish in law clear standards for identifying situations where shippers have no practical transportation alternative and thus are captive to railroads. The Congress should explicitly preclude use of the unrealistic concepts of "product" and "geographic" competition which the ICC has illegally sought to apply.
4. Require the ICC to take jurisdiction in captive situations upon request of a shipper and require that the railroad involved bear the burden of demonstrating reasonableness of rates, based upon reasonable costs (including reasonable return on investment that is used and useful.)
5. Reauthorize the Railroad Accounting Principles Board. This Board was authorized by the Staggers Act, but no money has been appropriated by the Congress to permit appointment of members and carrying out its functions. The time allowed for its work has now nearly expired, but work has yet to begin. Appropriations should also be provided immediately.
6. Require that the ICC promulgate clear standards for railroad accounting and reporting of costs. The ICC has been negligent in carrying out this key responsibility, thus making it nearly impossible for shippers to demonstrate unreasonableness of rates except at a very high cost for outside experts. Shippers have been forced to bear unreasonable burdens and costs to obtain information that should be provided by railroads.

B. *Changes should also be made in the membership of the ICC and the principles that guide its actions.*—Particularly during the past three years since enactment of the Staggers Rail Act of 1980, the ICC has repeatedly acted to favor railroads and permitted excessive rates—to the detriment of captive coal shippers and their customers and those producing the coal which must be shipped by rail. The ICC actions have also been detrimental to important national objectives, such as reducing U.S. dependence on foreign energy and reducing our balance of payments deficits because U.S. products are less competitive due to high rail shipping costs.

The Administration and the U.S. Senate (with the urging of members of the U.S. House of Representatives) should move promptly to nominate and confirm members for the ICC who will assure reasonable rail rates and provide a balance between the needs of railroads and those who the railroads shall be serving.

C. *Legislation providing the federal power of eminent domain for coal pipelines should be passed promptly.*—The ability to build coal pipelines—which are now being effectively blocked by the railroads—could reduce the monopolistic control over coal now enjoyed by railroads in many areas. Competition from coal pipelines would reduce the current need for federal regulation of rail rates.

It is now clear that minor changes in the Staggers Act and periodic oversight hearings will not solve the problems of excessive rail rates. The Congress has an opportunity to deal promptly and decisively with a problem of great importance to American consumers. We urge that legislation making the corrections described above be developed, introduced, and passed at the earliest possible time.

Thank you for the opportunity to present views and information for your consideration.

STATEMENT OF THE INSTITUTE OF SCRAP IRON & STEEL

The Institute of Scrap Iron and Steel, Inc., (Institute) is the national trade association representing over 1,200 member firms engaged in the processing and brokering of metallic scrap, and industry suppliers.

Institute members process, ship and otherwise handle approximately 90 to 95 percent of the iron and steel scrap purchased in the United States. Scrap processors handle, among other items, old automobiles, worn-out farm machinery, household appliances such as discarded freezers and stoves, structural steel from wrecked buildings and bridges and ferrous byproducts of industrial plants. Following removal of the nonferrous and nonmetallic matter or in the process of such removal, the scrap is cut, compressed, shredded or otherwise transformed into proper sizes for shipment to steel mills and foundries for recycling into new iron and steel. Rail is the dominant mode for shipping the industry's product.

The Institute accepted the Staggers Rail Act as a way to reduce government economic regulation in the presence of marketplace forces and to preserve the supervision necessary in competition's absence. By implementing regulatory reduction and monopoly supervision, the Act directed the Interstate Commerce Commission to balance the needs of shippers and carriers. Such was the Institute's expectation and, we believe, that of Congress. In fact, what has been observed since 1980 is a Commission attitude that exalts the goal of railroad revenue enhancement above the Act's co-equal goal of allowing competition to regulate rail prices. This focus on revenues need has distorted the Commission's approach to the problems of competitive and captive markets. The ironic result of Commission Staggers Act interpretations has been conversion of once competitive markets to monopolies and redefinition of once monopolistic markets as competitive.

The Institute calls the Subcommittee's attention to numerous instances of Commission disregard for the statute:

Failure to evaluate the competitive effects and efficiency aspects of route restrictions, joint rate cancellations and reciprocal switching eliminations;

Application of a test of "market dominance" that cannot be met by shippers with no transportation alternatives; and

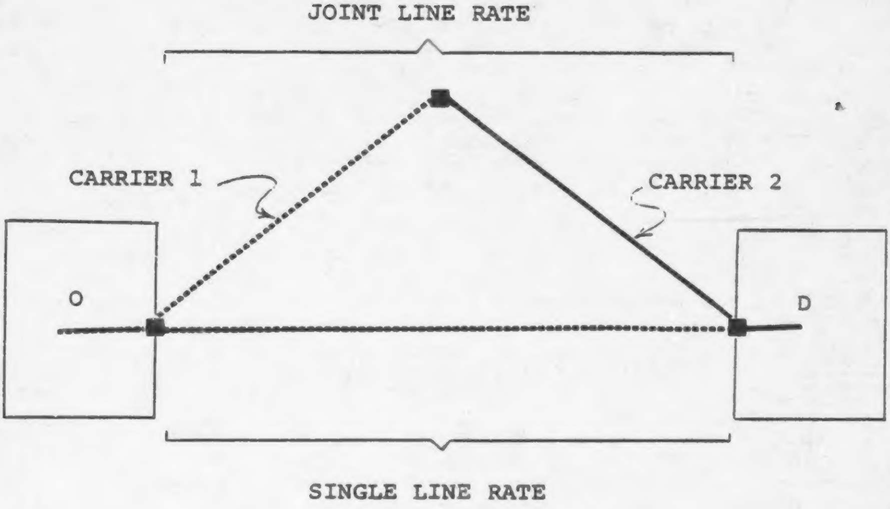
Adoption of an overstated measure as the "railroad cost adjustment factor."

In light of the divergence between Commission actions and the spirit and language of the Staggers Rail Act some corrective measures are required. The stress in Public Law 96-448 on marketplace forces can be enhanced with measures which would clarify the scope of antitrust immunity of shippers combining their traffic volume to gain negotiating leverage.

ROUTES, JOINT RATES AND RECIPROCAL SWITCHING

Many scrap iron shippers once enjoyed the benefits of reasonable interchange points, joint rates and reciprocal switching. For example, a shipper located at origin O on Carrier 1 and shipping to destination D on Carrier 2 has a choice between routing the shipment via Carrier 1 or via Carrier 1 and Carrier 2 (See Figure 1). As a result of Carrier 1's wholesale cancellation of joint rates, the shipper's only viable alternative is to route its traffic via Carrier 1 direct. In retaliation for loss of revenue over the Carrier 1-Carrier 2 route, the eliminated carrier either cancels reciprocal switching to D (requiring payment of the higher commercial switching charge—or minimum road haul) or directly raises the reciprocal switching charge. This action restricts access to service for movements to and from D.

FIGURE 1


JOINT LINE RATE
CARRIER 1
CARRIER 2
O
D
SINGLE LINE RATE

By an explicit joint rate cancellation or by closing gateways at which carriers could interchange traffic, the railroad acting unilaterally immediately increases the dollars it collects for handling traffic between O and D. It collects more because, although the margin by which the single line rate exceeds costs may be less than the margin for its portion of a joint line movement, it no longer has to share the revenue. For the future, the cancelling carrier also positions itself to improve revenue because the single line rate is no longer constrained by any alternative joint rate over the Carrier 1-Carrier 2 route. The substituted local route may be more costly for Carrier 1 to service (due to circuitry, grade, track condition) than the sum of Carrier 1 and Carrier 2 costs via the eliminated alternative.

The net effect is anticompetitive. Downward pressure on the single line rate is eliminated and the opportunity for marketplace forces to select the low-cost efficient option is lost. The adverse result is aggravated further because Carrier 2 has raised the price of access to Carrier 1's single line service. Whereas once Carrier 2's switching arrangement permitted the shipper equal access to Carrier 1 and Carrier 2 competing at D, elimination of switching reciprocity decidedly favors Carrier 2 to the shipper's detriment.

The Commission has allowed virtually all gateway closings, joint rate cancellations and reciprocal switching eliminations to become effective, making many once competitive rail transport markets even more monopolistic than prior to the Staggers Rail Act. Yet, the desire of Congress to give the Commission power to encourage competition could not have been more clear. By virtue of 49 U.S.C 11103(c)(1) added by the Staggers Act, the House Committee on Interstate and Foreign Commerce stated it "intends for the Commission to permit and encourage reciprocal switching as a way to encourage greater competition." H.R. Rep. 96-1035, 67 (1980). The language of the section is explicit concerning the relationship of reciprocal switching and competition.

"§ 11103. Use of terminal facilities

* * * * * * *

"(c)(1) The Commission may require rail carriers to enter into reciprocal switching agreements, . . . where such agreements are necessary to provide competitive rail service."

The Commission, instead, has looked to revenue need as a basis for holding that the serving carrier need not be subject to competition. *Universal Forest Products, Inc.* v. *SCL,* FD 29883.

This finding does not represent what the shipping public expected from the Commission: in the case of a request for reciprocal switching, a determination whether competition would be enhanced is the proper inquiry for an agency that has been directed to encourage competition. The Act should be changed to require that the Commission must order reciprocal switching upon shipper request where necessary to provide competitive rail service. A greater willingness of the ICC to order trackage rights, too, would encourage intramodal competition.

MARKET DOMINANCE

The ICC adopted in its post-Staggers Act formulation of market dominance criteria analytical tests which have no basis in the Act, namely geographic and product competition. The language of the Act explicitly refers to competition for the transportation to which the rate applies. Geographic competition involves analysis of whether a rail user can get scrap iron from different sources whereas, product competition involves an inquiry whether an alternative to scrap iron can be shipped instead. These issues have nothing to do with whether a scrap iron shipper in Cleveland had an alternative carrier to deliver its product in Pittsburgh.

RAILROAD COST ADJUSTMENT FACTOR

As an alternative to the regulatory lag inherent in the pre-1980 ex parte general increase process, Congress in the Staggers Rail Act provided a timely method for permitting rail carriers to offset the impact of inflation. That impact was to be measured with an index of railroad costs; on a quarterly basis that rise, if any, would be passed automatically to shippers.

The Act contemplated an index based on costs of output, not prices of inputs, and therefore requires some form of productivity adjustment to avoid overstatement of increases needed to offset actual cost rises for producing transportation service.

The Commission has ignored the direction of Congress to compile an index with "appropriate adjustments to reflect the quality and mix of material and labor." S. Rep 96-470, 52 (1979) In view of the many other instances in which the ICC has avoided the Act by using the rationale of revenue inadequacy, it is hard to attribute its slow response merely to the intellectual difficulties the task entails. Since the Commission last raised the prospect of developing a productivity adjustment in July 1982 and numerous parties illustrated various methodologies, the Commission has taken no action to adopt such a technique.

The shipping public has been assessed increases that are, by the Commission's own admission, overstated without the productivity adjustment. These percentage increases are applied to the entire rate, including profit, and not just the components directly impacted by inflation. The public continues to pay these upwardly adjusted rates even in times when the index has decreased.

CONCLUSION

Admonishment of the Commission by Congress is essential if the balance between maximum reliance on competition and effective captive shipper protection is to be restored. Competitive forces can be effective as regulators, but only if they are in evidence.

As the Subcommittee considers remedial language to guide the Commission back to the Staggers course, it might well consider extension of the philosophy to two additional areas.

The Institute membership is comprised of small volume shippers. They have observed the ease with which larger metallic scrap processing firms and ferrous scrap consumers have obtained contract and tariff rates based on volume. They, too, would like to participate. The Act appears to afford an opportunity for purchasers of rail transportation to obtain contracts and has long recognized the right of shipper associations to obtain volume discounts for members. At the same time, the law contains prohibitions against collective action by shippers to obtain similar rate treatment. The Institute's membership feels there is a need for clarification of a rather murky area so that the threat of antitrust violations will no longer inhibit efforts of small volume shippers to enjoy the ratemaking benefits of Staggers.

Another concern of the industry involves car supply. Under present rules and procedures, the nation's railroads have almost total control over the terms and conditions under which rail cars will be supplied. Would-be private owners or lessors of cars are at the mercy of the seving railroad, a competitor in the car supply business, to obtain permission to place private equipment in service. Once in use, such equipment is exposed to the high risk that unilateral action of railroads eliminates the profitability of private investments.

The scrap iron industry has experienced the adverse consequences of gondola shortages. In the mid-1970's, shortfalls were so severe that the unavailability of rail equipment added to the price of scrap iron. Ideally, shippers should be free to obtain equipment as needed from any source. The function of supplying cars should be made more competitive in the overall spirit of the Staggers Rail Act. 49 USC 10101a.

STATEMENT OF THE UNITED FRESH FRUIT & VEGETABLE ASSOCIATION

I. INTRODUCTION

The United Fresh Fruit and Vegetable Association, headquartered in Alexandria, Virginia, wishes to commend the Surface Transportation Subcommittee of the Committee on Commerce, Science and Transportation for conducting this oversight hearing. In addition, the association wishes to thank the subcommittee and its chairman for permitting United this opportunity to submit its comments on the implementation of the Staggers Rail Act of 1980.

United is the national trade association representing the fresh fruit and vegetable industry. Its membership numbers over 2,500 companies located in nearly all of the states. They are engaged in all facets of the fresh produce industry and include growers, shippers, receivers, wholesalers, retailers, produce and truck brokers, as well as motor, air, water and rail carriers. Collectively, the members of United handle more than eighty (80) percent of the fresh fruits and vegetables which are commercially marketed in the United States; a thirty-five (35) billion dollar a year industry.

Although a majority of fresh fruits and vegetables are presently transported by motor carriers, as recently as the 1960's the industry moved ninety (90) percent of its perishable commodities over the railroads. Even today, certain segments of the industry, such as the Northwest potato growers and California and Arizona citrus growers, rely heavily upon rail service.

As you know, the rail transportation of fresh produce has been deregulated for the past four years, reflecting a national trend towards less and less government involvement in various modes of transportation, such as the airline and motor carrier industries. In recent years the Congress has gradually reduced the federal regulations pursuant to which the railroad industry operates. The Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Rail Act of 1980 reflect Congress' desire to provide our nation's rail carriers with a greater amount of operating freedom. Although not yet completely deregulated, the railroad industry, as a whole, is moving closer and closer to where its fresh fruit and vegetable operations have been since 1979. Accordingly, United submits that its experience with the railroads under deregulation may give the members of this subcommittee a practical example of the manner in which a deregulated rail industry operates and of the pitfalls which may be encountered by all the shipping public one day.

A number of the provisions of the Staggers Rail Act affect the rail transportation of fresh fruits and vegetables, and United will gladly respond to the subcommittee's request for information on any one of them. For the purpose of this oversight hearing, however, United will focus its testimony on two sections of the law: first, Section 211 entitled "permissive Limited Liability Rates" 49 U.S.C. § 10730, and Section 213 captioned "Exemption", 49 U.S.C. § 10505. Both of these sections of the act affect the cargo liability standards for the rail movements of all commodities, regulated and exempt.

II. BACKGROUND

Rail liability standards for loss of and damage to cargo, such as fresh fruits and vegetables, are based on the traditional principles of bailment developed at common law. Under these longstanding principles a rail common carrier assumes absolute liability, with few exceptions, for any loss of or damage to the cargo which it transports.[1] In 1906, Congress adopted the Carmack Amendment to the Interstate Commerce Act, which embodies this general rule of common law.

The Carmack Amendment neither creates new substantive rights for shippers nor imposes any new obligations on the railroads beyond those developed at common law. Instead, the amendment merely sets forth convenient and well-recognized procedures for shippers, receivers and carriers to follow in settling loss and damage claims.[2]

Although part of the Interstate Commerce Act, the Carmack Amendment was neither intended to be nor has ever become part of the transportation regulatory scheme. Consequently, in March 1979 when the Interstate Commerce Commission exercised its authority to exempt the rail transportation of fresh fruits and vegetables from the regulatory provisions of the Interstate Commerce Act, shippers and receivers of fresh produce logically and reasonably assumed that the common law principles of absolute liability would remain in effect.[3]

Pursuant to this decision of the Commission, a number of rail carriers began to interpret the exemption order as also freeing them from traditional common carrier responsibility for loss of and damage to fresh fruits and vegetables. As a result of this unfounded interpretation, basic common law liability standards, incorporated in the Carmack Amendment, were being unilaterally negated by some railroads through terms and conditions of "exempt" bills of lading which were often offered to shippers and receivers of the exempted perishable commodities on a "take it or leave it" basis. (See Section IV A, infra.) Under these contracts the ability of a shipper to recover for loss of and damage to its cargo, while in the sole possession of the rail carrier, has been greatly reduced and, as a practical matter, frequently eliminated.

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[1] Pursuant to interpretations by the Supreme Court, a rail common carrier is liable for the full actual value of loss of or damage to goods transported by it unless it can show that the loss or damage is attributable to an act of God, the public enemy, the act of the shipper himself, public authority or the inherent vice of the nature of the goods. See, *Missouri Pacific R. Co.* v. *Elmore & Stahl*, 377 U.S. 134 (1964), rehearing denied, 377 U.S. 948.

[2] Specifically, the Carmack Amendment provides for, inter alia: issuance of a through bill of lading by the originating carrier; joint and severable liability of all joint-line carriers participating in the haul from origin to destination; codification of the common law obligation compelling common carriers to reimburse shippers for the "full actual loss" incurred in transit; application of liability rules to reconsigned and diverted shipments; application of liability rules whether or not a bill of lading is issued by the carrier; exemption of switching carriers from liability as a delivering carrier; the recovery by a connecting carrier from a negligent carrier of any amount it is required to pay the claimant; limitations on where carriers may be sued for losses; time limits for the filing of claims and suits; provisions for limiting a carrier's liability through released rates; and a definition of disallowances of claims by carriers and their insurers.

[3] The exemption authority of the Commission is contained in section 10505 of the Interstate Commerce Act, 49 U.S.C. § 10505. See Ex Parte No. 346 (Sub. No. 1), Rail General Exemption Authority—Fresh Fruits and Vegetables, 44 Fed. Reg. 18227 (1979) codified at 49 U.S.C. and 10526(a)(6)(E).

Similar confusion arose concerning the applicability of Carmack Amendment liability standards on the rail movement of exempt commodities when the Interstate Commerce Commission exercised its authority under Section 213 of the rail act, codified at 49 U.S.C. § 10505(f), "to exempt transportation that is provided by a rail carrier as part of a continuous intermodal movement." Accordingly, in Ex Parte No. 230 (Sub. No. 5), Improvement of TOFC/COFC Regulation, 46 Fed. Reg. 14348 (1981), codified at 49 CFR §§ 1039, 1090 and 1300, the Commission exempted "rail and truck service provided by rail carriers in connection with trailer on flat car (TOFC) and container on flat car (COFC) service from economic regulation."

Based upon the experience of the fresh fruit and vegetable industry, a number of shippers and receivers were concerned that the TOFC/COFC exemption order might be interpreted by the railroads as relieving them from the provisions of the Carmack Amendment concerning their liability for loss and damage. In response to a petition for a declaratory order, the Commission clarified this question stating that "railroad tariffs or contractual items on TOFC/COFC service which violate the terms and conditions of the Carmack Amendments are unenforceable as a matter of law." See 46 Fed. Reg. 32257 (1981). Despite the ICC's 1981 ruling that the provision of the Carmack Amendment must apply to exempt TOFC/COFC movements, many railroads have repeatedly failed to provide shippers and receivers with contracts containing full liability protection.

III. THE STAGGERS RAIL ACT OF 1980

In an attempt to prohibit a railroad from contracting away its responsibility for cargo liability, the Staggers Rail Act of 1980 reaffirmed the applicability of Carmack Amendment liability standards to rail movements of exempt commodities, such as fresh fruits and vegetables. Specifically, Congress included Section 213 in the act, codified at 49 U.S.C. 10505(e), which states that "no exemption order . . . shall operate to relieve any rail carrier from an obligation to provide contractual terms for liability and claims which are consistent with provisions of Section 11707 [the Carmack Amendment] . . ."

In addition, Section 211 of the Staggers Rail Act directed the ICC and the Department of Justice (DOJ) to study independently the continuing need for Carmack Amendment liability protection and to submit its legislative recommendations to Congress by October 1, 1981. By notice published in the Federal Register issue of March 20, 1982, 46 Fed. Reg. 17893 (1981), the Commission solicited written comments from interested parties for its study. On behalf of an industry-wide coalition, United submitted comments and a reply statement to the Commission in June and July of 1981, respectively. After reviewing the numerous comments which it received, the ICC submitted its final report to Congress on September 29, 1981.

In Ex Parte No. 403, Cargo Liability Study; Report to Congress, Id., the Commission concludes that the Interstate Commerce Act should be amended to eliminate the venue restrictions contained in the Staggers Rail Act of 1980 because they appear to be unduly severe as applied to shippers and receivers. Also, the Commission recommends an amendment to the act to remove the $10,000 jurisdictional threshold for access to the Federal courts and to treat litigation arising under the Carmack Amendment as a Federal question, regardless of the dollar amount of the claim involved. According to the report, a further recommended amendment to the Interstate Commerce Act would provide the courts with the authority to award attorneys fees to successful claimants absent an equitable, efficient and inexpensive arbitration program.

Moreover, in the report the transportation regulatory agency states that it does not support the adoption of a comparative negligence standard in cargo liability cases or the implementation of a no-fault liability concept. In addition, the Commission does not recommend to Congress a change in the present burden of proof developed at common law and reaffirmed through decades of judicial opinions which a shipper or receiver must meet to establish its loss and damage claim. The views of the Commission expressed in the report, which has been forwarded to Congress, are consistent with the position of United and its members.

Likewise, the Rail Carrier Liability Study conducted by the Department of Justice shares many of the same fundamental conclusions contained in the ICC report. It is of primary importance that the DOJ report affirms the applicability of Carmack Amendment liability standards, absent an agreement between the parties to the contrary. (Such agreements limiting liability would involve contract rates or released rates.) Moreover, the reports of the department and the ICC concur that the venue restrictions contained in the Staggers Rail Act are unduely restrictive and that the pre-Staggers venue provisions should apply.

Of particular interest to shippers and receivers of fresh fruits and vegetables is the concluding statement in the ICC's report that the agency will continue to require rail carriers to offer rates for full liability protection. On the other hand, the agency does note that it lacks jurisdiction over the reasonableness of the full value rates offered by the railroad in situations where the shipper or receiver has available to it alternate modes of transportation. Accordingly, the Commission indicates to Congress that the practical effect of this jurisdictional restriction on its authority is to provide shippers and receivers with a right to be offered rates for full liability protection, but without an administrative remedy to challenge unreasonable or excessive rates. In other words, when the fresh fruit and vegetable industry has been offered by the railroads "unreasonable or excessive rates" for full liability protection, Congress and the ICC have collectively, although assuredly unintentionally, denied it any administrative recourse. This is a critical situation of which the members of this subcommitte should be aware and on which you should be prepared to act. (See Section V, infra.).

IV. IMPACT UPON THE FRESH FRUIT AND VEGETABLE INDUSTRY

As discussed, supra, the Carmack Amendment to the Interstate Commerce Act embodies long-standing principles of rail common carrier liability developed at common law. This absolute liability standard was applicable to rail transportation prior to the creation of the Interstate Commerce Commission and it was specifically incorporated in the Interstate Commerce Act by Congress in 1906. In the Staggers Rail Act of 1980, Congress reaffirmed the applicability of the liability standard for loss and damage claims and specifically stated in Section 213 of the act that it even applies to the rail transportation of exempt commodities, such as fresh fruits and vegetables, and exempt service, such as rail TOFC/COFC movement. More recently, as noted above, the Interstate Commerce Commission has solicited and received public comments concerning the continued viability of Carmack Amendment liability standards. The record developed in Ex Parte No. 403, supra, provides ample justification for maintaining the current standards and procedures for loss and damage claims. Accordingly, the Commission has conveyed to Congress its Cargo Liability Study; Report to Congress, containing the support of the agency for retaining the full liability standards embodied in the Carmack Amendment. Likewise, as noted above, the Department of Justice has sent to Congress its Rail Carrier Liability Study containing similar conclusions.

Despite the clear historical basis and presently recognizable need for requiring rail carriers to comply with the Carmack Amendment, the experience of the fresh fruit and vegetable industry since deregulation is disturbing. For example, rail carriers have refused to enter good faith negotiations with shippers and receivers of fresh produce to establish mutually acceptable transportation contracts; although approved in the Staggers Rail Act, released rates have been illegally and unfairly used by rail carriers to supplant previous full liability rates or to represent the only economically feasible transportation rate; long established and well understood claims procedures embodied in the Carmack Amendment have been abridged and distorted by the rail carriers under deregulation; free from federal regulations, rail carriers have illegally and unfairly denied produce shippers and receivers basic common law liability protection; and absent any recourse for administrative review, shippers and receivers of fresh fruits and vegetables have been victimized by monopolistic pricing practices and self-serving route and gateway cancellations on the part of the rail carriers.

These problematic developments, since rail transportation of fresh fruits and vegetables was deregulated by the Interstate Commerce Commission, are discussed in greater detail below.

A. Bilateral, good faith, negotiations of exempt rail transportation contracts have rarely, if ever, occurred since deregulation.

Anticipating the March 1979 decision of the Interstate Commerce Commission to deregulate the rail transportation of fresh fruits and vegetables, certain rail carriers began to develop "exempt" transportation contracts which drastically altered the rights and responsibilities of the involved parties. For example, both the Southern Pacific Lines (SP) and the Atchinson, Topeka and Santa Fe Railway Company (Santa Fe), which collectively provide nearly exclusive rail service to major produce growing regions of California and Arizona, proceeded to reduce significantly their potential loss and damage liabilities. Despite repeated protests by California and Arizona growers dependent upon the services of the SP and Santa Fe, both carriers unilaterally implemented new "exempt" rail transportation contracts, with the acceptably restrictive liability provisions, on May 29, 1979, just two months after the ICC exempted the carriers from federal regulations.

Objecting fresh fruits and vegetable shippers were promptly informed by both carriers either to abide by the offensive terms and conditions of these "exempt" contracts or face a total discontinuation of all rail services. The now famous Thomas Hobson apparently offered his customers a similar "choice," subsequently known as a Hobson's choice, relating to transportation by horse in the 17th century.

Obviously, fruit and vegetable packing houses located along railroad tracks have had no alternative except to rely upon these carriers to transport some of their commodities to market. Despite repeated attempts by California and Arizona growers and shippers to seek modification of the SP and Santa Fe contracts, the restrictive liability provisions remain intact, today. (See Sections IV B, C and D, infra.)

Two conclusions can be reached regarding the shippers' initial experience with the railroads under deregulation. First, despite contrary assertions by the SP and Santa Fe, neither carrier conducted good faith negotiations with fresh fruit and vegetable shippers. Indeed, it is all but impossible for rail customers to negotiate a fair and reasonable transportation agreement underneath the ominous cloud of a threatened service discontinuation. Second, due to the perishable nature of fresh produce, a shipper is inevitably forced, at some time, to load his first rail boxcar despite the unacceptable, unilaterally imposed contract. Thereafter, it becomes exceedingly difficult, if not impossible, for him to convince the rail carrier to modify the terms of the contract.

B. Rail carriers have illegally and unfairly offered shippers of fresh produce an alternative between only released rates or a choice between released rates and prohibitively expensive full liability rates under deregulations.

Section 211 of the Staggers Rail Act authorizes the use of "permissive limited liability rates," also known as released rates, "under which the liability of the carrier for . . . property is limited to a value established by written declaration of the shipper or by a written agreement between the shipper and the carrier . . ." In addition to this possibility of offering released rates to shippers and receivers, Congress reiterated the existing requirement that carriers continue to offer full liability rates even for exempt commodities, such as fresh fruits and vegetables. In Section 213 Congress specifically states: "No exemption order . . . shall operate to relieve any carrier from an obligation to provide contractural terms for liability and claims which are consistent with the provisions of section 11707 (the Carmack Amendment to the Interstate Commerce Act)."

It logically follows from a reading of the statute and its legislative history that Congress fully intended the availability of released rates to be in addition to traditional full liability rates. After discussing the newly sanctioned released rates, the conference report states: "Full value rates will of course continue in effect for the use of those shippers and receivers which choose not to utilize released rates. . . ." See H.R. Rep. No. 96-1430, 96th Cong., 2nd Sess 102 (1981).

Accordingly, under the law, a carrier must offer full liability rates and may offer released rates, too. Likewise, under the law the shipper and receiver may select the released rate, is one if offered, and also must have a full liability rate from which to choose.

Recently, a New York City Civil Court reviewed these rate-related sections of the Staggers Rail Act and concurred in this interpretation. In *Fruitoc Corp.* v. *Consolidated Rail Corp.,* No. 44096-82 (N.Y.C. Civ. Ct., dec. filed April 26, 1983), the court concludes that the law obligates rail carriers to provide contractual terms consistent with the requirements of the Carmack Amendment, but permits them to offer alternative terms. Specifically, the court states: "The carrier's unalterable obligation under Staggers is to provide terms consistent with Carmack. The option under (Section 213 of the law) permits the carrier to offer other terms as alternatives to those consistent with Carmack." Id. at 5.

Contrary to the statute and this subsequent judicial interpretation, many rail carriers have offered shippers and receivers of fresh produce only a released rate, which is frequently equal to the rate charged for full liability protection prior to passage of the Staggers Rail Act. For example, the Union Pacific Railroad, which annually transports more than fifty (50) percent of the Idaho potato crop, has illegally and unfairly failed to offer growers a full liability rate.

Similarly, the Southern Pacific only recently offered released rates to California growers, more than three (3) years after enactment of Staggers. Even when shippers specifically requested full liability rates, as Sunkist Growers, Inc., headquartered in Van Nuys, California, did in a letter dated January 21, 1981, SP declined to offer them. Although terms consistent with the Carmack Amendment had always been available from SP before 1979, the carrier's reply to Sunkist stated that full liability rates had suddenly and inexplicably become prohibitively expensive and that Sunkist should reconsider its request. (See affidavit of R.A. Brown, Pricing Mng., Southern Pacific Lines, Dec. 31, 1982, *Fruitco Corp.* v. *Consolidated Rail Corp.*, supra.) When the civil court judge in the *Fruitco* case discovered the failure of SP to comply with the full liability requirements of the law, he invalidated the limited liability provision of the SP master transportation agreement pursuant to which the carrier had transported fresh fruits and vegetables since deregulation. Shortly before the court actually handed down its adversed decision, but well after SP began to appreciate its possbile ramifications, the carrier finally offered the legally required full liability rates, effective January 1, 1983.

During the past seven months, shippers and receivers desiring full liability protection from the SP must pay a premium above the preexisting released rate. Although the records of United citrus-growing members indicate that the carrier's actual cost of assuming full liability is approximately sixty (60) to seventy (70) dollars per car load, the SP has imposed a surcharge of two hundred-fifty (250) dollars per boxcar. United submits that the carrier has arbitrarily selected this surcharge amount with the dual purpose of technically complying with the statutory requirements of Staggers, while effectively discouraging the selection of Carmack Amendment protection. Because the cost of acquiring full liability protection from SP is prohibitively expensive, United and its members know of no shippers or receivers of fresh fruits and vegetables that have been able to afford the Congressionally-assured and judicially-mandated full liability protection.

Shippers and receivers dependent upon the Santa Fe Railway Company have encountered similar difficulties acquiring Carmack Amendment liability protection since the passage of the Staggers Rail Act. During the first half of 1981, Santa Fe informed its fresh produce customers that it would assume full liability "subject to a premium of $350 plus 15 percent of the transportation charge." In other words, if the rail carrier charges $4,800 to ship a boxcar of Valencia oranges from Bakersfield, California, to New York City, which was the applicable Santa Fe rate on June 25, 1981, then the premium rate for full liability protection would be an additional charge of $1,070 per carload; resulting in a total transportation charge of $5,870.

Under this Santa Fe formula the premium rate for additional liability protection is more than twenty (20) percent of the base cost of transporting a fifty (50) foot, mechanically refrigerated boxcar coast-to-coast. Moreover, the premium rate is nearly fifteen (15) times the estimated insurance cost associated with assuming full liability. Obviously, no shipper or receiver could realistically afford such an exhorbitant surcharge on each boxcar, so Santa Fe never had to assume the full liability for the perishable commodities which it hauled under this formula.

By August 1981, faced with outraged shippers and receivers, even Sant Fe acknowledged that this excessive rate was unconscionable and reduced it to approximately $200 per carload, depending upon the specific commodity being transported. United submits that such dramatic rate fluctuations further attest to the arbitrariness associated with establishing these full liability costs.

By August 1981, faced with outraged shippers and receivers, even Santa Fe acknowledged that this excessive rate was unconscionable and reduced it to approximately $200 per carload, depending upon the specific commodity being transported. United submits that such dramatic rate fluctuations further attest to the arbitrariness associated with establishing these full liability costs.

Moreover, an additional requirement of the Santa Fe further discourages the utilization of full liability protection. Under the Santa Fe master transportation contract a shipper desiring full liability protection contained in the Carmack Amendment must notify the carrier twenty-four (24) hours prior to loading the railcar. At that time, the shipper must advise the Santa Fe when and where the rail car will be available for representatives of the carrier to inspect the loading methods and lading. This pre-shipment inspection procedure is unique to the Santa Fe and clearly not required by the Carmack Amendment or at common law. Combined with the arbitrary, excessive and unreasonable surcharge, the inspection requirement further serves to discourage shippers and receivers from obtaining traditional full liability protection.

To the best of United's knowledge, only one (1) receiver, located in Montreal, Canada, for one (1) carload of fresh produce, has paid to Santa Fe the $200 premium for full liability protection and complied with its twenty-four (24) hour notice and inspection procedures. Out of the thousands and thousands of boxcars of fresh fruits and vegetables which have been loaded and transported under deregulation, only a single receiver on a single carload has received the Congressionally-assured full liability protections embodied in the Carmack Amendment.

C. Long established, reasonable and commonly understood claims procedures embodied in the Carmack Amendment have been unfairly abridged and unilaterally distorted by the rail carriers under deregulation.

Since its incorporation into the Interstate Commerce Act in 1906, the Carmack Amendment has provided to shippers, receivers and rail carriers a reasonable and universally understood time framework for the resolution of loss and damage claims. Under the Carmack Amendment a written claim for loss and damage must be filed by a shipper or receiver within nine (9) months after the claim arises. Once filed, if a claim is rejected by the rail carrier, the shipper or receiver has two years to bring suit against the railroad.

The preparing, processing and resolving of loss and damage claims are time-consuming steps. The Carmack Amendment sets forth convenient and well-recognized procedures pursuant to which the parties involved can settle their disputes. Indeed, it is the position of United that these procedure have worked throughout the 1900's to reduce and resolve loss and damage claims. Unfortunately, since the ICC exempted rail transportation of fresh fruits and vegetables and Congress passed the Staggers Rail Act, the transportation contracts imposed by carriers upon shippers and receivers of fresh produce have significantly shortened the time limits for filing claims and for initiating suits.

For example, the current contracts of the Southern Pacific and the Santa Fe require claims to be filed within six (6) months, instead of nine (9), as permitted under Carmack. The SP contract gives the carrier six (6) months to settle or decline the claim, whereas Santa Fe has four (4) months to respond. United members have found that claims filed after the six (6) month filing deadline are automatically declined for procedural reasons without regard to the merit and substance of the claim. However, both the SP and Santa Fe routinely allow their responses to claims filed within a timely manner to exceed their own contractual deadlines of six (6) and four (4) months, respectively.

As a result, when shippers or receivers exceed the contractual time periods, their penalty is immediate denial of the loss and damage claim. On the other hand, when the rail carriers exceed their own contractual time periods, they incur no real penalty. In fact, their dilatory response only serves to penalize further the claimant, who is forced to wait longer and longer for the resolution of his claim.

Once a claim is denied by the SP, the claimant has one (1) year to file suit, instead of two (2) years under Carback. The time limitations in the Santa Fe contract are even more restrictive. Their contract requires that a suit must be brought within one (1) year after the date of delivery of the shipment. Therefore, if the claimant needs his contractually-insured six (6) month period to prepare and file his claim and the Santa Fe declines the claim within its allotted four (4) month period, then the claimant is left with a mere sixty (60) days to initiate a court challenge. United contends that there is no defensible reason for imposing upon the claimant such a ludicrously brief period of time, particularly when federal statute ensures shippers of regulated commodities a two (2) year period in which to commence a lawsuit. United submits that the sole purpose of this contractual provision is to provide the Santa Fe with a procedural loophole to avoid otherwise legitimate liability for loss of and damage to the cargo which it transports.

Frequently, the seasonal and perishable nature of fresh produce compels growers to concentrate upon the distribution of an entire year's crop before they can divert their attention to filing loss and damage claims. In addition, few produce growers have a year-round need to employe a full-time transportation manager who can quickly handle any claims-related problems. Even many large, produce growing corporations with a full-time transportation manager and staff may reassign them to the sales department during peak harvesting intervals. Consequently, many shippers and receivers are required to delay the preparation and submission of loss and damage claims until the end of the shipping season. Under these circumstances, the railroads fully comprehend the disadvantage at which their abbreviated filing deadlines have placed produce growers and shippers. It is a disadvantage which contradicts decades of Carmack Amendment claims procedures; it is a disadvantage which denies claimants rightful compensation for losses; and it is a disadvantage which promotes unaccountability for railroad negligence.

Under the restrictive time constraints contained in the rail transportation contracts, legitimate claims may be denied for procedural reasons. United submits that, in many cases, compliance with these shortened time limitations is extremely difficult, if not absolutely impossible. In a deregulated environment where rail carriers are free to impose rigid time limitations upon claimants and to flaunt such restrictions, themselves, the only available recourse is to wage a time-consuming and expensive court battle against the offending railroads. Given the duration of a typical lawsuit and its associated costs, shippers and receivers are understandably reluctant to initiate judicial proceedings. Aware of this dilemma, Congress has passed laws and the ICC has adopted regulations so aggrieved parties can pursue administrative procedures to resolve claims-related problems. United submits that this fundamental and sound public policy should not be contravened under the guise of economic deregulation.

D. Rail carriers have illegally and unfairly denied produce shippers and receivers basic common law liability protection since deregulation

As discussed in Section II, because rail carriers are in sole possession of the commodities during their movement, courts have long held them fully liable for any loss of or damage to the cargo, unless the carrier can prove that the harm was not a result of its own negligence, but resulted from an act of God, a public enemy, an act of the shipper himself, public authority or the nature of the goods. Since deregulation the railroads have incorporated into their contracts certain restrictions on their liability and procedural condition precedents which obviously dilute or eliminate the full liability standards which have been applicable to rail common carriers for centuries.

The Southern Pacific, and the Santa Fe, the Union Pacific (UP) and the Burlington Northern (BN) railroads have clauses in their contracts establishing a $100 claim minimum. By definition this minimum directly contradicts the full liability standard developed at common law, yet most produce shippers and receivers have reluctantly absorbed these losses which usually result from minor breakage. In many instances, this type of damage has become generally recognized by reasonable shippers and receivers as part of the inherent risk associated with using mechanically refrigerated railcars.

On the other hand, only the SP has recognized that these minimums tend to encourage minor losses resulting from petty thefts while the boxcar is in the sole possession of the railroad. Therefore, the SP contract will honor claims of less than $100 when there is evidence of broken, missing or replacement seals on the rail car when it is delivered. Unfortunately the other three railroads have refused to be accountable for the actions of either its own personnel or of the people with whom it maintains business relationships for purposes of transporting rail cars.

The existence of minimum claim clauses which allow petty theft is not only a source of constant irritation to shippers and receivers of fresh produce, it represents an unlawful reduction of the carrier's absolute liability required under the Carmack Amendment.

The marketing of a perishable commodity with a limited shelf life results in a volatile pricing situation. The cost of a carton of lettuce can vary twenty (20) percent from day-to-day. The value of a rail car of various tree fruits can range from $7,000 to $35,000 depending upon the specific commodity and the time of year. As a result, it is extremely important that deliveries of fresh produce are made in a timely manner. Even a twenty-four (24) hour delay can have a significantly adverse economic impact upon the seller of fresh fruits and vegetables.

Consequently, courts have held rail carriers liable for losses incurred by the shipper or receiver when a boxcar is delivered late in a declining market. These are called market decline losses, and they can be significant if a $35,000 carload of deciduous tree fruit arrives twenty-four (24) or forty-eight (48) hours late during which time its market value has fallen ten (10) or twenty (20) percent.

Since deregulation, some carriers, such as the Burlington Northern, the Family Lines Rail System and the Chessie System Railroads, have refused to honor any market decline claim. Some carriers, such as the Santa Fe, have unilaterally granted themselves a twenty-four (24) hour "grace period" beyond the scheduled delivery time during which they will not honor market decline losses. In other words, if a receiver is expecting a carload of table grapes on Sunday which does not arrive until Monday evening, the receiver will be barred by the railroad contract from recovering for any losses suffered as a result of a Monday drop in the market value of the table grapes.

Other carriers have intentionally added burdensome preconditions with which claimants must comply in order to have a market decline claim even considered. For example, the Southern Pacific requires claimants to obtain price quotations based upon U.S. Department of Agriculture (USDA) market information before ever considering a market decline claim. Unfortunately, recent reductions in federal spending have eliminated USDA market quotes on the daily prices of fresh produce in several cities. The SP knows this, yet by requiring non-existent information, they are able to decline many legitimate market decline claims.

Similarly, Santa Fe routinely requires non-existent information before it will review any claims submission, including claims for breakage, decay, freezing, shortage or market decline. Specifically, the carrier requests inclusion of origin and destination inspection reports by U.S.D.A. personnel as part of all claims filings. Prior to deregulation, these inspection reports were never required by the carriers, and as a practical matter, origin U.S.D.A. inspections are never performed on fresh citrus shipments from California and Arizona and rarely performed on the other commodities. Although Santa Fe is aware of this, the railroad continues to require claimants to provide this information to it. United submits that these inspection requirements are intended to harass claimants and designed to reduce or eliminate the carriers' liability.

An additional area of contention between the members of United and the Santa Fe concerns the carrier's attempt to exonerate itself from any liability relating to claims for physical damage to the load. In its "Uniform Contract for Transportation of Excempt Agriculture Commodities" Santa Fe states in Paragraph 12 that "responsibility for adequate blocking, bracing, packaging and loading of the shipment lies entirely with the shipper." Paragraph 24 of the contract reads as follows:

"Responsibility for adequate packaging, loading, and bracing of the shipment lies entirely with the shipper. Carriers shall not be liable for breakage or bruising damage to lading unless there is physical evidence of railroad negligence. Minor shifting of a load alone shall not be considered evidence of railroad negligence.

"Santa Fe and connecting carriers shall not be liable for deterioration resulting from improper loading or overloading of the equipment, or from the use of containers or stacking methods which do not permit the adequate flow of air throught the load."

Read together, Santa Fe had relied upon these two paragraphs to deny virtually all breakage, load shifts and physical damage claims. When confronted with these claims, the carrier has regularly maintained that there is no "phyiscial evidence of railroad negligence." Since the railroad is in sole possession of the facts regarding the manner in which the rail car was transported, the claimant is placed in the impossible position of affirmatively proving carrier negligence, contrary to common law and judical precedents, which presume carrier negligence absent an affirmative defense.

The claimant's dilemma is compounded by the withdrawal of the Santa Fe from the Transcontinental Freight Bureau which prescribes recommended standards for packaging commodites and industry recognized techniques for loading and bracing rail cars. Other railroads, such as the Southern Pacific, retain membership in the freight bureau and know whether produce shippers are utilizing approved containers and loading techniques. Based upon their voluntary absence from the programs at the bureau, the Santa Fe can conveniently decline all breakage claims because the carrier has no way of independently verifying the claimant's compliance with bureau-approved standards.

The Santa Fe has also chosen to thwart recent initiatives of growers and shippers of California grapes and deciduous tree fruits intended to improve rail car loading procedures and to reduce breakage claims. Earlier this year a committee of the California Grape and Tree Fruit League, whose members grow and ship approximately seventy-five (75) percent of California's and Arizona's grapes, plums, pears, peaches, apricots, apples, cherries, figs and nectarines, developed a fifty-three (53) page "Recommended Standard Loading Guideline for TOFC and Rail Shipments" dated April 30, 1983. League members ship approximatey 75,000 truck and rail loads of perishable commodities annually, and each rail carrier, including the Santa Fe, was invited to participate in developing the loading guidelines and to endorse them. As a result, the SP contributed to the process and has subsequently approved the manual. On the other hand, Santa Fe refused to become involved in this effort. Consequently, despite their good faith attempt to cooperate with the railroad, these growers and shippers do not know what Santa Fe considers to be acceptable packaging standards and loading procedures. Moreover, this lack of cooperation from the railroad leaves Santa Fe free to continue to decline legitimate breakage claims, in which the carrier has been clearly negligent, because it conveniently cannot and intentionally will not verify the integrity of the shipper's container or loading technique.

E. Shippers and receivers have been victimized by rail carriers exhibiting monopolistic pricing practices since deregulation.

In general, United Subscribes to the position that even without federal regulations competition between common carriers of the same mode of transportation promotes reasonable rates, efficient schedules, reliable services, and equitable settlement of claims. The concern of fresh fruit and vegetable shippers, as well as many other agricultural and industrial shippers, is that frequently there is only one rail carrier within a particular geographic origin or destination to handle the traffice. For example, Idaho potato growers are dependent upon the Union Pacific for rail service; Northwest apple growers are captive to the Burlington Northern; Florida growers can only use The Family Lines Rail System or its wholly owned subsidiary Seaboard Coast Line Railroad; terminal market receivers in Jessup, Maryland, are captive to the Chessie System Railroads; and other receivers in Norrtheastern markets must rely exclusively on Consolidated Rail Corporation to deliver their shipments of fresh produce.

Serious anticompetitive problems often arise even where two rail carriers offer service within the same state. For example, some growers in California, who are willing to reposition loads around the state, may be able to utilize either the Southern Pacific or the Santa Fe railroads. In some locations both carriers may share trackage rights, such as in Kern County, California, where potatoes are grown. during this season's peak shipping period, Kern County potato growers discovered that Santa Fe equipment was unavailable and that SP rates, set by its perishable traffic subsidiary Pacific Fruit Express (PFE), had suddenly and significantly increased. For example, in mid-June of this year a comparison of rates between Santa Fe, whose equipment was unavailable, and PFE, which had adequate supplies of equipment and no competition from another railroad, reveals a $995 rate difference to Chicago, Illinois; a $551 rate disparity to New York, New York; and a difference of $478 for a PFE carload of potatoes to Boston, Massachusetts.

PFE's dramatic abuse of its temporary monopolistic position caused Northeastern potato buyers to purchase Idaho or Colorado potatoes. In order for the their perishable produce to remain competitively priced, Kern County growers experienced a seventeen (17) percent decrease in the selling price of their potatoes over a five day period, in effect, absorbing the exhorbitant PFE increase in the transportation rates.

It is becoming clearer and clearer to California produce shippers that Santa Fe, whose recent equipment shortage prompted PFE to escalate rates, is gradualy retiring its fleet of mechanically-refrigerated boxcars without replacing them. For example, the carrier will retire all of its forty-eight (48) foot cars within the next three (3) months, thereby reducing their total fleet of refrigerated equipment to approximately 1200 railcars. As a result, the temporary equipment shortage in June will assume a more permanent status in the foreseeable future. As a result, PFE, which has already displayed a tendency towards monopolistic pricing practices in the absence of any competitive restraints, will be free to set boxcar rates for numerous California fruits and vegetables, not just for potatoes. Even more so than before, the Pacific Fruit Express will be able to dictate the terms of its exempt transportation contracts without regard for the shipping public.

Although it is understandable, even commendable, that the railroads intend to take advantage of the flexibility and opportunities accorded to them under deregulation, United believes that neither Congress nor the ICC have approved of or acquiesced in such blatant displays of monopolistic behavior.

F. Rail carriers have demonstrated a self-serving disregard for the shipping public by implementing route cancellations and gateway closings and by imposing proportional rates and surcharges since deregulation.

In theory the ICC's decision to deregulate rail transportation of fresh fruits and vegetables was to provide the railroads with the necessary rate and routing flexibility to respond rapidly to the distribution demands of the perishable food industry. In reality, it was the last and perhaps only chance for the railroads to compete effectively with the increasing efficiency of the exempt agricultural motor carrier.

In the 1950's, railroads transported more than ninety (90) percent of our nation's produce. By 1979, rail carriers retained less than ten (10) percent of that traffic. Year after year railroad service had steadily deterioriated, while their transportation rates continued to increase as a result of a relentless series of ex parte proceedings before the ICC. Railroad delivery schedules on a transcontinental shipment averaged thirteen (13) days, whereas a truck would deliver the load in less than a week, often in five (5) days. Although the advent of railroads deregulation posed a great deal of "unknowns" for shippers and receivers, as well as for the carriers, there understandably existed, in many ways, a what-have-we-got-to-lose attitude.

During the first quarter under deregulation, rail delivery times did improve. Southern California and Arizona shippers using the Southern Pacific through East St. Louis to New York City averaged ten (10) days in transit. Northern California shippers availed themselves of the reinstated "Salad Bowl Express", which originated on the Southern Pacific and was routed over the Union Pacific (UP), Chicago and North Western (C&NW) and finally Conrail, reaching New York in less than seven (7) days. Santa Fe reduced the transit time in its coast-to-coast service, which averaged eleven (11) days prior to deregulation, to almost seven (7) days within three (3) months after the ICC grants its exemption.

Basically, from 1979 through 1982 California and Arizona growers have relied upon two (2) originating carriers offering a choice of three primary routes to Chicago, Illinois, where traffic destined for Northeastern markets in the U.S. and Canada is interlined with delivering rail carriers. Santa Fe owns trackage rights from all originating points in the two states to Chicago, Illinois, so it can offer direct service from Barstow, California to Kansas City, via Arizona and New Mexico, and into Chicago.

SP, the other originating carrier, must route traffic over the tracks of other railroads to deliver cars to Chicago, the "gateway" to the East. For example, until earlier this year, SP routed shipments originating in Central California via Ogden, Utah, and the Union Pacific (UP), to Fremont, Nebraska, at which point the Chicago and North Western (C&NW) delivered it to Chicago. SP moved loads from Southern California and Arizona via New Mexico and the St. Louis Southwestern Rail (SSW) to Kansas City, at which point either the Burlington Northern (BN) or The Milwaukee Road (MILW) used to deliver it to Chicago.

Although more than one (1) railroad is always involved in a transcontinental shipment of fresh produce, the originating carrier normally quotes a single origin-to-destination transportation rate, known as a joint line rate. This joint line rate is agreed upon by all the carriers involved in the movement with each railroad receiving a percentage or proportional share of the total rate, known as its revenue division. In 1983 shippers and receivers of fresh produce began to experience a dramatic upheaval in the rate and route structure of the SP when relationships among the connecting railroads deteriorated.

Effective February 1, 1983, rates on shipments destined to Canada and handled from Kansas City to Chicago by The Milwaukee Road (MILW), instead of the BN, were discounted substantially when only MILW agreed with SP and SSW to participate in a joint line rate reduction. For example, the rate for boxcars moved via MILW was $3,829 compared with a rate of $4,157 when the BN participated in the same overall movement.

On March 3, 1983, Conrail decided that its revenue division was inadequate and added a per carload surcharge, in addition to the joint line rate, of $200 for equipment destined for Boston, New York and Philadelphia and of $100 for boxcars heading for other Conrail destinations. After five (5) days of intense customer and carrier protests, Conrail withdrew the surcharge on March 8, only to reapply it on March 12. In late April the joint line rate agreement between SP and Conrail collapsed, and on May 1, 1983, Conrail institutionalized proportional rates. Since that time, shippers and receivers moving fresh produce across the country must determine what the rate is for the California-to-Chicago leg of the trip, which depends upon whether the MILW or the BN is involved, which route is available and what proportional rate Conrail is charging for its segment of the journey.

Despite the complications associated with proportional rates, produce shippers took brief consolation in the hope that the internal rate battles between the SP and Conrail had ended; however, on July 7, 1983, SP informed members of United that shipments using Conrail for East Coast deliveries would cost four (4) percent more than cars delivered to the same destination by Chessie System Railroads. Within two (2) weeks this rate differential grew to fifteen (15) percent. This meant that on July 24, 1983, a boxcar of California produce destined for Philadelphia, Pennsylvania, cost $677 more to interchange with Conrail in Chicago or in East St. Louis than with the Chessie System. This illogical and counter productive rate disparity between shipments handled by Contrail and Chessie remains in effect, today.

The confusing situation was further complicated when a dispute over guaranteed minimum revenue requirements between the SP and two of its interlining carriers, the Union Pacific and the Burlington Northern, resulted in further rate disparities. Effective May 7, 1983, shippers of fresh fruit and vegetable railcars originating on the SP and moving to Chicago via the northern route involving the UP or via the southern route involving the BN paid an extra eight (8) percent rate differential, or approximately $450 per car, compared with the applicable rate for the same California-to-Chicago movement when The Milwaukee Road was involved. Obviously, whenever possible shippers and receivers have attempted to avoid using the UP or BN routes. On June 2, 1983, the Southern Pacific notified its customers to expect a one (1) day delay on cars handled by the UP through Ogden, Utah, presumably due to decreased traffic resulting from the significant rate differential. In other words, the railroads, because of internal bickering over which neither the shipping public nor the federal government has control, have simultaneously increased rates and decreased service.

Most recently, on Friday, July 29, the Southern Pacific notified fresh fruit and vegetable shippers that its service into Chicago, Illinois, the "gateway" to the East, would be discontinued effective July 31, 1983. With a mere two (2) days notice, the members of United learned that the Chicago gateway was closed to them for SP shipments, apparently a casualty of the continuing rate-related discord between SP and the BN, which had transported SP trains from Kansas City to Chicago. Henceforth, the Southern Pacific will route all California and Arizona produce shipments to East St. Louis via Kansas City and the St. Louis Southwestern Railway (SSW), a wholly-owned subsidiary of Southern Pacific. Once in East St. Louis, The Alton & Southern Railway (ALS), a small terminal carrier serving the St. Louis-East St. Louis gateway, must transport the railcars to the tracks of Conrail, Chessie or other eastbound rail carriers.

Historically, the East St. Louis gateway has provided dismal service, so United members are extremely concerned about this abrupt route change. Unfortunately, if this service is unacceptable, then produce shippers dependent upon the Southern Pacific for rail service no longer have any other route options available; only the East St. Louis gateway.

Despite the reliable and reasonably priced service of the Milwaukee Road to Chicago, the SP has used its market dominant position to route all of its east bound equipment through its wholly-owned subsidiary SSW. The carrier's single-minded determination to guarantee all of its business to its subsidiary is blatantly anti-competitive and contrary to the interests of the shipping public. Given the flexibility inherent in deregulation, rail carriers are permitted to act in this manner. Under deregulation complicated tariffs can be replaced by confusing rate sheets, often more than three (3) feet long, based upon percentages of a base rate. Under deregulation convenient joint-line rates can be replaced by proportional rates, often accompained by surcharges and premiums. Under deregulation the availability of a dependable route or gateway can be eliminated on a day's notice. Under deregulation a reliable and reasonably priced interlining carrier can be circumvented. And finally, under deregulation, rates can increase while service decreases and the shipping public is left without recourse.

V. LEGISLATIVE RECOMMENDATIONS

Rail carriers may ingenuously suggest technical compliance with the intent of Congress and the provisions of Carmack Amendment, but in practical terms, United respectfully submits that unreasonable pricing practices and claim filing restrictions have circumvented and undermined the clearly expressed will of the national legislature, the dictates of common law and the requirements of statutory authority.

The Interstate Commerce Commission and the Department of Justice are well aware of these developments and continue to reaffirm the applicability of Carmack Amendment protection and procedures to exempt rail transportation. On the other hand, the Staggers Rail Act precludes the Commission from exercising jurisdiction over these matters absent a showing of rail carrier market dominance. In so doing, Congress has guaranteed the continuation of long-standing liability standards for rail movements in a manner which permits railroads to eliminate effectively this Carmack Amendment protection where a shipper or receiver has available to it alternate modes of transportation. United respectively submits that this paradox is an illegal and counter productive situation which must be addressed by this subcommittee, in particular, and by the Congress, in general.

Based upon the foregoing discussion, United respectively urges this subcommittee to adopt and Congress to enact legislation that:

1. Will restore to the Interstate Commerce Commission the authority to review the reasonableness of full value rates and the differential between full value and limited value of released rates;
2. Will require rail carriers to offer to shippers and receivers full value rates;
3. Will require any limited value rates offered by rail carriers to be lower than prevailing full value rates which were in effect on October 1, 1980;

4. Will repeal all rail exemptions from the Carmack Amendment and subject the rail transportation of all commodities to the claim regulations of the ICC, 49 C.F.R. Section § 1005; and

5. Will codify the recommendations of the Interstate Commerce Commission contained in Ex Parte No. § 403 regarding repeal of the restrictive venue limitations for filing loss and damage suits and waiver of the $10,000 jurisdictional amount required for loss and damage suits to filed in federal court.

VI. CONCLUSION

Based upon the foregoing discussion, United respectively urges the subcommittee to examine closely the matter of cargo liability standards for the rail transportation of exempt agricultural commodities, including fresh fruits and vegetables. Moreover, United submits that the experience of its members throughout the past four (4) years raises legitimate concerns about total deregulation of all rail transportation.

United appreciates this opportunity to submit its views to Congress and commends the members of the subcommittee for conducting these oversight hearings.

STATEMENT OF WEYERHAEUSER CO.

Weyerhaeuser Company is one of the nation's largest producers of forest products. The Company employs approximately 41,000 people in 133 manufacturing facilities at 82 locations throughout the country. In 1982 sales exceeded $4.1 billion. As a major producer and shipper of lumber, plywood, particleboard, pulp, paperboard and paper products, Weyerhaeuser is heavily reliant upon the railroads to economically deliver these and other forest products to market.

Weyerhaeuser Company has been, and continues to be, a strong advocate of transportation deregulation. The Company, primarily through its industry associations, actively supported passage of the Staggers Rail Act. In our judgment, deregulation in general, and the Staggers Act in particular, are having the effects Congress intended.

Continued reliable rail service for our industry requires the availability of very large numbers of high quality, clean and, often specialized boxcars. Our heavy dependence on the availability of such cars to our production facilities, leads Weyerhaeuser to be extremely concerned about the probable effects of the May 2, 1983 ICC decision to deregulate boxcar traffic.

Although the Company owns six short line railroads, its concerns regarding this decision are as a major shipper, not as a carrier.

The ICC boxcar decision would impact 1,346 of the 3,659 cars owned or leased by our Class III carriers. These specialized cars were acquired through our short lines to meet our shipping needs after the Class I railroads serving our facilities indicated an unwillingness to invest in the type of equipment required by our mills. By obtaining these cars, the Company hoped to avoid the serious boxcar shortages it has experienced in the past.

Under the provisions of the ICC's boxcar decision, these cars are unlikely to be available for the majority of Weyerhaeuser shipments in the future. This is because the loss of per diem 72 hours after the car is made empty, combined with an empty backhaul mileage charge of up to $.35/mile, will likely have an adverse affect on the economic viability of boxcars owned or leased by Class III railroads.

Estimates are that revenues on these cars could be reduced under the new ICC rules by as much as 97 percent. Since most of this income flows from the Class III railroads directly back to the car owner in the form of lease payments, the lessors will undoubtedly be unable to meet their debt repayment obligations, resulting in foreclosures on the equipment.

Although it is true that the foreclosing financial institution will have every financial incentive to make these specialized cars available for further product movements, there will be little economic incentive for the short line railroads needing those cars to request them back. At a possible cost of $.35/mile for the empty backhaul, shippers like ourselves, located many miles from our major markets, will find it uneconomic to request their return. Furthermore, the Class I railroads will have every incentive to load their own cars with backhaul cargo, and those of other trunk carriers, before loading those now owned or leased by the short lines to serve their shippers. Such cars will likely go into storage in large numbers, creating congestion in car flows and a chaotic situation that will adversely impact the country's rail transportation system.

The foreclosing entity would likely attempt to sell the cars to a new investor. The only potential investors who could make a reasonable return on an investment in this equipment would be the major Class I railroads; those companies who, under the new rule, would received the benefit of the $.35/mile on empty backhauls, the relief from per diem 72 hours after a car is made empty, and the reimbursement for resultant widespread car storage. Even if the boxcars were priced at a significant discount of current market value, it would be difficult for a potential investor other than a Class I railroad to justify the investment; the outbound revenues simply wouldn't be adequate to offset the operating costs imposed by the new rules. With their present oversupply of standard boxcars, it is unlikely the Class I railroads would acquire the specialty cars that we need for efficient damage-free movement of our products.

This places the major Class I carriers in a position to establish considerable control over the long term supply of boxcars, and, by implication, the rates at which cars move. Such market power puts small captive railroads, as well as similarly dependent captive shippers, at a serious long-term economic disadvantage.

It is true that the rule will permit short line railroads to negotiate with the trunk carriers for car hire and service. But, in reality, such negotiations would be totally one sided; short line railroads simply have no leverage on a trunk line upon which they are totally dependent for an adequate supply of boxcars.

In the near term, some of Weyerhaeuser's facilities would find it impossible to adjust to the likely loss of car supply after the rule goes into effect November 7, 1983. For example, at Weyerhaeuser's Valliant, Oklahoma, paperboard mill, 95 percent of the production moves by rail, regardless of length of haul. Thirty to forty boxcars per day are loaded at Valliant seven days per week. This is equivalent to 110 truckloads per day—too great a number of vehicles for the Valliant facility to load, even if it were economically feasible for it to do so.

Regulatory transitions of this magnitude should not occur so rapidly as to force economic dislocations of this kind. At a minimum, the ICC should stay and perhaps phase in implementation of its decision so that all those dependent upon the nation's rail system can be assured of orderly progress toward much needed deregulation.

In addition, the Congress, through oversight hearings of the type held on July 26 and 27, should continue to closely monitor the ICC's implementation of the Staggers Rail Act. Such close congressional scrutiny encourages strict regulatory attention to the objectives and intent of deregulation, without threatening the free market which legislative efforts toward deregulation were intended to foster.

Weyerhaeuser Company commends the subcommittee for holding these oversight hearings, and looks forward to working closely with its members and staff on these issues.

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, D.C., April 8, 1983.

Senator JOHN DANFORTH,
Chairman, Subcommittee on Surface Transportation,
Washington, D.C.

DEAR JACK: I have enclosed a copy of a letter I recently received from a constititent in Idaho. I think he has raised some legitimate complaints about several aspects of the Staggers Act. I would appreciate it if you would include his concerns in the next hearings scheduled on this subject.

I appreciate your concern in advance.

Sincerely,

JAMES A. MCCLURE.

Enclosure.

BENNETT LUMBER PRODUCTS, INC.,
Princeton, Idaho, March 21, 1983.

Hon. JAMES MCCLURE,
U.S. Senate,
Washington, D.C.

DEAR SIR: Bennett Lumber Products, Inc. is experiencing some present at well as potential problems resulting from the Staggers Act. We're certain that these problems could, if not corrected, have disasterous results for this as well as other companies that ship by rail. This act, that brought about deregulation is being interpreted by some railroads as a license to act in an irresponsible, if not unethical manner.

The greatest present and potential danger is that the act encourages the railroads to enter into contracts with larger shippers. These contracts allow for considerably lower shipping rates. These lower transportation expenses give the larger shipper a considerable unfair advantage by cutting their cost thus allowing them to receive higher profit percentage for their products. When any company receives lower rates for shipping over the same rail and equal distance, the profit percentage gained gives it a considerable advantage in the purchasing of raw materials and/or manufacturing costs. These advantages could well make it impossible for anyone to start a new company that would have to rely on the railroads to ship their products. A new company would simply be unable to compete against the advantages allowed their large competitors. The results of this practice alone will also insure the death of many existing small companies.

Another very real danger of this act lies in allowing the railroads the total freedom to decide to accept or deny to ship private or special cars. Many lumber products companies have with the railroads encouragement, purchased "special railcars". These railcars are specifically designed to ship lumber products. The special nature of these cars allow for either greater ease in loading/unloading or increase product protection. The railroads encouraged this practice because they either decided to purchase only a limited number or as in most cases not to purchase any of these special cars. During good economic times all agreed with this practice, however, during depressed periods they argue that their cars are frequently idle while they must ship the "private cars". It is our experience that private cars do not generate a profit for the owning company, but simply assist in the transportation of their manufactured products. In periods of poor national economic health the expensive private cars are also idle but with the new deregulation, some railroads are again considering methods of restricting or denying the shipment of these cars. If allowed to decide which cars to accept, the railroads would use private cars only when all of their own cars were committed, causing the private car owner to idle his expensive fleet and frequently use cars that are sub quality.

The railroads are a form of monopoly whether we acknowledge it or not and while total regulation results in efficiency some control may be preferred. The original intent of the Staggers Act might have been productive, however, in practice this absolute power of the railroads could prove disruptive and unproductive for all except the railroad. To quote a railroad official "the Staggers Act frees the railroad from having to treat all customers equally". We fear that if left to their own control, this "unequal treatment" will become unfair, unethical, unproductive if not terminal for many customers who must ship by rail.

We would like for some type of follow-up hearing to be considered, that would examine the results in detail of this deregulation.

Thank you.

Very truly yours,

GARY TRAGESSER,
Transportation Manager.

U.S. SENATE,
Washington, D.C., July 25, 1983.

Hon. JOHN C. DANFORTH,
Chairman, Subcommittee on Surface Transportation, Commerce, Science, and Transportation Committee, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Your Subcommittee on Surface Transportation has scheduled hearings on the Staggers Rail Act for July 26 and 27, 1983. As you may know, a large number of Senators have formally expressed deep concern over the economic and regional impacts of that portion of the Interstate Commerce Commission's May 2, 1983 order which addressed car hire compensation rules. These rules threaten, in fundamental ways, the ability of Class III or shortline railroads, their shippers and the owners and lessors of box cars utilized by Class III railroads to compete and survive. I am enclosing copies of a number of letters from Members of the House and Senate to the Commission on this subject. I would appreciate it if you would make these letters part of the Subcommittee's July 26 and 27 hearing record.

The Western states are primarily exporters of resources and raw and finished materials to other consuming states and abroad. Our states provide lumber, paper and other timber products, minerals, agricultural goods and other materials to the industrial centers and consuming regions of the country. The ability of many businesses and industries in our states to compete successfully is often tied to relatively small differentials in both the quality and in the cost of transportation. Many of our industries rely on Class III railroads and specialty box cars to move their predominantly outbound loaded cars to markets. The Commission's Order imposes fundamental changes in transportation arrangements for Class III railroads and shippers which gravely imperil these industries and important sectors of our regional economies.

I am also enclosing a set of questions concerning the Commission's May 2, 1983 Order. I would greatly appreciate it if you would direct these questions, as appropriate to Secretary Dole, the Chairman and Members of the Commission and other witnesses during the course of the hearing. The dissenting option of Chairman Taylor and the large number of requests for reconsideration and stay of the Commission's Order by shippers, shortline railroads and owners of box cars raise serious questions which must be addressed by the Commission or, failing prompt and appropriate Commission action, by the Congress.

Sincerely,

John Melcher.

Enclosures.

House of Representatives,
Washington, D.C., June 3, 1983.

Mr. Reese Taylor, Jr.,
Chairman, Interstate Commerce Commission,
Washington, D.C.

Dear Chairman Taylor: We concur with your and Commissioner Simmons dissent from the ICC's decision served on May 2, 1983, Ex. Parte no. 346, Sub. no. 6., *Boxcar Deregulation.* We urge the ICC to reconsider the rule based on these dissents and many of the arguments made by railroads, the Departments of Defense and Agriculture, other shippers, associations and non-rail carriers.

We agree that the decision does not meet the statutory criteria of the Staggers Rail Act. The rule is not limited in scope, close boxcars account for over 40 percent of the nation's rail traffic. A number of shippers presented persuasive data to demonstrate that market power abuse is likely to exist on a significent amount of traffic. CONRAIL and other supporters of the exception did not, in our estimation, amply contradict those assertions.

Regulation should be based on common-sense and minimized when possible. It is, however, short sighted and reckless to deregulate the entire system of rail freight movement by boxcar. Boxcar dergeulation cannot be compared to previous ICC decisions since those decisions have dealt with specific commodities or covered piggyback traffic. This rule will lead to the arbitrary reversal of other ICC decisions based on commodities, since many of these can be shipped by boxcar.

Shortline railroads, the lifeblood of a rational rail freight average, may be forced out of business because of the change in the car share system. Because of lower overhead, better knowledge of the areas they serve, and a number of other factors, these railroads have been able to operate at a profit in regions of the country where large railroads cannot. The CONRAIL proposal on car hire/car service, which was made part of the rule, will dismentle the shortline system, stranding shippers and removing an important element of our transportation network.

The boxcar rule, made in response to a petition by government-owned CONRAIL, is a clear example of government operating in its own self-interest and ignoring the needs of private business.

We strongly recommend that the Commission reconsider this decision, and we thank you in advance for yur attention to this matter.

Sincerely,

James N. Jeffords, Douglas H. Bosco, Bill Patman, Claudine Schneider, Berkely Bedell, Webb Franklin, Earl Hutto, David R. Obey, Carl D. Pursell, Tom Vandergriff, Jim Leach, G. F. Montgomery, William L. Dickinson, Toby Roth, Gene Chappie, W. G. Hefner, Robert W. Kastenmeier, J. Roy Rowland, Howard C. Nielson, Lee H. Hamilton, Wayne Dowdy, Arlan Stangeland, Norman D. Shumway, Olympia J. Snowe, Norman D. Dicks, Trent Lott, Douglas K. Bereuter, Thomas E. Petri, Thomas S. Foley, William F. Clinger, Jr., Tom Harkin, Doug Barnard, Jr., Thomas J. Tauke, Jamie L. Whitten, Al Swift, Charles Wilson, Carrol A. Campbell, Jr., Roy Dyson, Barbara Boxer, and F. James Sensenbrenner, Jr.

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, D.C., June 9, 1983.

Hon. REESE H. TAYLOR, Jr.,
Chairman, Interstate Commerce Commission,
Washington, D.C.

DEAR CHAIRMAN TAYLOR: The Committee's decision to modify car hire compensation rules in Ex Parte 346 (Sub No. 8) raises many unanswered questions about the future viability of shortline operations and the shippers they serve. In particular, I am concerned about the retroactive application of the storage and empty movement charges to Class III railroads. These small railroads will have little or no bargaining power with the larger Class I railroads. Moreover, the Class III railroads acquired boxcars in specific reliance upon Congressional and administrative inducements and the guarantee of fair compensation.

A Petition for Reconsideration of the Commission's decision was filed by the BRAE Corporation on May 20, 1983 which would exclude boxcars owned by or leased to shortline railroads from the Commission's Order. After carefully reviewing the Petition and the record of the original proceeding, I believe the Commission may have overlooked the impact its new car hire rules will have on owners of boxcars on Class III railroads. There are substantial legal and equitable questions raised that deserve further examination. I urge you to reconsider the impact the new rules will have on Class III railroads by approving the BRAE Petition.

Please circulate this letter to the other Commissioners. Thank you.

Sincerely,

MARK ANDREWS,
Chairman, Senate Appropriations Subcommittee on Transportation and Related Agencies.

U.S. SENATE,
Washington, D.C., June 13, 1983.

Hon. REESE H. TAYLOR, Jr.,
Chairman, Interstate Commerce Commission,
Washington, D.C.

DEAR MR. CHAIRMAN: As you know, some members of the Senate Commerce, Science and Transportation Committee have previously expressed concern about the impact that the Commission's decision in the boxcar exemption case (*Ex Parte No. 346 (Sub-No. 8)* would have upon small railroads, their shippers, and their lessors.

Having reviewed the Commission's written order, and the Petition for Reconsideration filed by BRAE Corporation, the undersigned members of the Committee would like to support the BRAE petition. We believe that the Commission overlooked the impact its order would have on car owners whose boxcars are owned by, or leased to, Class III railroads primarily for use by shippers on their own lines.

We support the primary thrust of the Commission's order, namely the deregulation of rates. However, the re-regulation of car hire compensation should not be applied retroactively to Class III railroads for the reasons expressed in both the BRAE Petition for Reconsideration and the statements filed in general support of that petition.

Boxcars which were acquired in good faith by Class III railroads primarily for use by shippers on their own lines do represent a class of cars that deserve the Commission's separate attention and special treatment. The owners of these cars had reason to rely on the "fair compensation" standard and a retroactive change would place their investments in unwarranted jeopardy.

We would suggest that the Commission, in acting on this petition for reconsideration, consider limiting the duration of the "grandfathering" of such cars to a period long enough to fully amortize their underlying debt. After that, the cars could be treated as all other cars, and the legal and equitable arguments in favor of providing the petition's requested relief will have been met.

Thank you for considering our views.

Sincerely,

SLADE GORTON.
WENDELL H. FORD.
HOWELL HEFLIN.
NANCY LANDON KASSEBAUM.
ROBERT W. KASTEN, Jr.
TED STEVENS.

U.S. Senate,
Committee on Commerce, Science, and Transportation,
Washington, D.C., June 17, 1983.

Hon. Reese H. Taylor, Jr.,
Chairman, Interstate Commerce Commission,
Washington, D.C.

Dear Mr. Chairman: As you know, some members of the Senate Commerce, Science and Transportation Committee have previously expressed concern about the impact that the Commission's decision in the boxcar exemption case *(Ex Parte No. 346 (Sub-No. 8))* would have upon small railroads, their shippers, and their lessors.

Based upon the information we have received, we believe that the Commission may have overlooked the full impact of its order on car owners whose boxcars are owned by, or leased to, Class III railroads. All parties to the proceeding must share responsibility for this oversight.

We would suggest that the decision on car hire compensation might, as applied to Class III railroads, be re-examined in light of impacts which were not originally considered. In this regard, the Commission might consider staying the Order as to car hire compensation for Class III railroads and undertaking an expeditious rulemaking to determine the proper course of action to pursue with regard to car hire compensation for boxcars acquired by Class III railroads.

Sincerely,

Ernest F. Hollings.
Russell B. Long.
Donald W. Riegle, Jr.
John C. Stennis.
Thad Cochran.

U.S. Senate,
Washington, D.C., June 17, 1983.

Hon. Reese H. Taylor, Jr.,
Chairman, Interstate Commerce Commission,
Washington, D.C.

Dear Mr. Chairman: As Congressional representatives of Western states, we are deeply concerned about the impact of some aspects of the Commission's recent Order concerning railroad boxcars (*Ex Parte No. 346 (Sub-No. 8))* on the economies of our states. While the Commission's Order did deregulate rates for most commodities transported on boxcars, it *reregulated* or changed the existing regulations governing car hire which must be paid for the utilization of boxcars. These modified regulations will have serious impacts on our states, on our Class III railroads, on the shippers they serve, and on car owners whose boxcars are owned by or leased to Class III railroads.

As you know, the Western states are primarily exporters of resources and raw and finished materials to other consuming states and abroad. Our states provide lumber, paper and other timber products, minerals, agricultural goods and other materials to the industrial centers and consuming regions of the country. The ability of many businesses and industries in our states to compete successfully is often tied to relatively small differentials in both the quality and in the cost of transportation. Many of our industries rely on Class III railroads and specialty boxcars to move their predominantly outbound loaded cars to markets. The Commission's Order imposes fundamental changes in transportation arrangements for Class III railroads and shippers which imperil these industries and some sectors of our regional economies.

In view of the serious regional impact that some of the provisions of the Commission's overall Order have on our states and on industries critical to our continued growth and well-being, we respectfully request that the Commission initiate an appropriate proceeding or proceedings to consider matters that may not have been taken into account in the original proceedings, but which we feel are of central importance.

We leave it to the Commission to determine whether this proceeding should take place in the context of considering a pending petition for reconsideration of the Order; a stay of the new Order as to all boxcars owned or leased by Class III railroads and initiation of a rulemaking proceeding on car hire compensation for Class

III railroads pursuant to § 11122, title 49 U.S.C.; or in some other appropriate Commission proceeding. Our concern is that this matter has serious economic consequences to our states and our constituents and it should be carefully examined in light of all of the facts and the questions which have been expressed to date and before the Order becomes effective.

Our request and the issues it presents for the Commission are limited in scope and warrant the Commission's careful consideration. If an orderly process of deregulation of transportation and other major sectors of our economy is to proceed successfully this process must be perceived by the public and the Congress as rational, orderly, equitable and sensitive to the interests of all sectors of the country and to the needs of both small and large companies.

Thank you for your consideration of this request.

Sincerely,

Henry M. Jackson, Max Baucus, Mark O. Hatfield, Orrin G. Hatch, Paul Laxalt, John Melcher, Alan Cranston, Pete Wilson, Quentin N. Burdick, Pete V. Domenici, Jake Garn, Dennis DeConcini, Steven D. Symms, Chic Hecht, James A. McClure.

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., June 17, 1983.

S. LYNN SUTCLIFFE, Esq.,
Van Ness, Feldman, Sutcliffe, Curtis & Levenberg,
Washington, D.C.

DEAR LYNN: As you requested, I have reviewed the information provided on the May 2, 1983 decision of the Interstate Commerce Commission (ICC) regarding car hire compensation for the rail industry, and have contacted Chairman Taylor to ask that BRAE's petition be granted.

Thank you for bringing this matter to my attention.

Sincerely,

NORMAN D. DICKS,
Member of Congress.

U.S. DEPARTMENT OF TRANSPORTATION,
Washington, D.C., June 20, 1983.

Re ex parte No. 346 (Sub-No. 8), exemption from regulation—boxcar traffic.

Ms. AGATHA L. MERGENOVICH,
Secretary, Interstate Commerce Commission,
Washington, D.C.

DEAR Ms. MERGENOVICH: The Department of Transportation (DOT) is today filing a formal reply to the petitions for reconsideration of Sea-Land Service and Totem Ocean Trailer Express. The purpose of this letter is to address certain other issues raised for reconsideration, particularly those relating to boxcars which are used regularly or exclusively by a single shipper.

DOT is in fundamental agreement with the May 2, 1983 decision of the Commission. The decision advances needed deregulation, the benefits of which are outlined by the Commission at page 20 of its decision. In addition, the Commission has, we believe, properly dealt with the problem of empty, and therefore non-productive, movement of freight cars around the country.

Notwithstanding DOT's approval of, and agreement with, the Commission's decision, we do suggest that the Commission consider the advisability of a separate proceeding to deal with boxcars owned or leased by Class III railroads which are used regularly or exclusively by one shipper. This issue, which has been raised most forceably in the Petition for Reconsideration of Brae Corporation, applies to a relatively limited number of cars (Brae asserts the total is 11.6% of the present national pool). Separate treatment for these cars has, nevertheless, received considerable support, particularly from Class III railroads. The Commission itself acknowledges at page 26 of its decision that "Short line railroads, on the other hand, may have good cause to be concerned about the near term effects of the proposal."

Because DOT is not convinced that the evidence now before the Commission is sufficient to fully evaluate the exemption sought by Brae, we urge the Commission to consider a separate proceeding to deal with those boxcars owned or leased by Class III railroad and in regular or exclusive use by one shipper.

Our second suggestion relates to the empty car return problem. It is apparent to us, and we believe to the Commission also, that simple boxcar rate exemption would have little effect unless accompanied by a solution to the empty car return problem. In that regard, we suggest that the Commission's ruling be more specific than as set forth in its May 2 decision. For example, we believe that the Commission should state rules that will apply in the absence of bilateral car hire agreements. These rules would address such issues as 1) the maximum appropriate daily storage charge, 2) when the storage charge would end in the event that a request for the return of an empty car is received, 3) how, ultimately, must a car be returned (since the railroad holding the car is no longer paying per diem charges, there might be little incentive to return the car promptly even if no net storage charge is being levied), 4) whether per diem shall be paid during the car's return trip to its owner, and 5) under what circumstances would an owner be responsible for the car return charge of 35 cents per mile when the movement is directed by another party, such as the Commission.

Sincerely,

ROSALIND A. KNAPP,
Deputy General Counsel.

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, D.C., June 20, 1983.

Hon. REESE H. TAYLOR, Jr.,
Chairman, Interstate Commerce Commission,
Washington, D.C.

DEAR MR. CHAIRMAN: On May 2, 1983 the Interstate Commerce Commission took action with respect to railroad boxcar hire compensation rules, in connection with a proceeding docketed as Ex Parte No. 346 (Sub. No. 8). I understand that the new rules, which are scheduled to go into effect on November 7, 1983, reduce by nearly one-half the amount that railroads are required to pay when they use boxcars from another carrier. The new rules also allow railroads to charge the boxcar owner a fee for the return of the car.

The Commission should consider the economic effects of the new rules on small, so-called "Class III" railroads. It seems to be likely that large railroads will have little difficulty in negotiating boxcar return agreements among themselves that cancel out any negative economic impact on their operations. Class III railroads do not have the market power to match the bargaining position of the large railroads, and so will be forced to accept the terms set by the large railroads for boxcar return fees.

I have received information that the South Branch Valley Railroad in West Virginia will be injured by the new rules. The 51-mile line is operated by the West Virginia Railroad Maintenance Authority, and it does business as the South Branch Valley Railroad (SBVR). SBVR originates south of Moorefield, West Virginia, in Hardy County, and runs northeast through Hampshire County to Green Springs, West Virginia, where the line interconnects with the Baltimore & Ohio Railroad.

The West Virginia Railroad Maintenance Authority treats SBVR as a developmental railroad and a public utility. As such, any agreements negotiated with large railroads concerning car return fees—which the new rules would make necessary—must be cleared by the Attorney General of the State of West Virginia. That would be an expensive and time-consuming process for SBVR and the Attorney General's office.

The region through which SBVR runs is the major poultry-producing area of West Virginia. In a report to the Federal Railroad Administration, the manager of SBVR calculated that nearly $100 million in economic activity will be generated by the line over the next eight years. Much of that activity will be directly related to the poultry production and processing industries served by SBVR.

SBVR currently leases 50 boxcars for the use of shippers on the line. Those cars are unlikely to be available to SBVR if the new car hire rules go into effect, as the owner of the cars will lose money under the new rules. Rather than absorb the loss, the owner will dispose of the cars elsewhere. That could deprive the shippers on SBVR of adequate service, and deprive the line itself of car hire compensation revenues.

I am confident that the South Branch Valley Railroad situation is not unique. Under the circumstances, I urge the Commission to reconsider the effects that the boxcar hire compensation rules will have on small railroads. The rule should be modified to exempt boxcars owned by or leased to Class III railroads, so that these small lines are not subjected to severe economic damage or bankruptcy.

I serve on the Subcommittee on Transportation and Related Agencies of the Committee on Appropriations, under the leadership of Senator Mark Andrews. I understand that he has contacted the Commission concerning this matter, and I believe that our positions on this issue are similar.

Please circulate this letter to the members of the Commission.

Thank you for your consideration of this matter.

With best regards, I am,

Sincerely,

ROBERT C. BYRD.

U.S. SENATE,
Washington, D.C., June 29, 1983.

Hon. REESE H. TAYLOR, Jr.,
Chairman, Interstate Commerce Commission,
Washington, D.C.

DEAR MR. CHAIRMAN: As you know, some members of the Senate Commerce, Science and Transportation Committee have previously expressed concern about the impact that the Commission's decision in the boxcar exemption care (*Ex Parte No. 346 (Sub-No. 8)*) would have upon small railroads, their shippers and their lessors.

Based upon the information we have received, I believe that the Commission may have overlooked the full impact of its order on car owners whose boxcars are owned by, or leased to, Class III railroads. All parties to the proceeding must share responsibility for this oversight.

I would suggest that the decision on car hire compensation might, as applied to Class III railroads, be re-examined in light of impacts which were not originally considered. In this regard, the Commission might consider staying the Order as to car hire compensation for Class III railroads and undertaking an expeditious rulemaking to determine the proper course of action to pursue with regard to car hire compensation for boxcars acquired by Class III railroads.

Sincerely,

PAUL TRIBLE.

CHEMICAL MANUFACTURERS ASSOCIATION,
Washington, D.C., July 26, 1983.

Hon. JOHN C. DANFORTH,
Chairman, Committee on Commerce, Science, and Transportation, Subcommittee on Surface Transportation, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Attached is a statement of the Chemical Manufacturers Association which we request be made a part of the formal record of the July 26 and 27, 1983, hearings of the Senate Surface Transportation Subcommittee on implementation of the Staggers Rail Act.

As one of the largest groups of rail shippers, the chemical industry strongly supports the basic philosophy of the Staggers Act that rail-to-rail competition should reduce regulation. However, we must regrettably report that, in our view, the Interstate Commerce Commission (ICC) has failed to implement the Act according to Congressional intent. The ICC not only has failed to encourage more competition, but also has permitted many large railroads to erect blatant anticompetitive barriers to existing competition. In effect, railroads nationwide are allowed to refuse to interchange traffic to competitor railroads. A refusal to interchange enables the railroad that serves the shipper to keep the shipper's traffic captive to its rail system. Without competitive alternatives, the shipper and its customer can be subjected to monopolistic freight rates, circuitous routing, shipping delays, and other service deteriorations. If Congress permits the ICC to continue on this course, only a few large railroads will remain, and they will be in a position to improperly take advantage of their dominant market position.

We also attach proposed amendment language that would clearly foster rail competition, and urge you to consider it in the context of providing the ICC with further and more explicit direction.

The chemical industry continues to view matters relating to rail competition as being of major importance. We would be happy to respond to any questions. Our

Transportation Counsel is Kenneth M. Kastner (887-1160) and our Legislative Manager is W. Alan Woodford (887-1136).

Sincerely,

WILLIAM M. STOVER,
Vice President and Director
of Government Relations.

Attachments.

STATEMENT OF THE CHEMICAL MANUFACTURERS ASSOCIATION

The Chemical Manufacturers Association is a nonprofit trade association whose member companies produce more than ninety percent of the chemicals manufactured in this country. The largest percentage of our chemicals are trasported by rail at a rail freight bill of over six billion dollars per year. CMA actively participated in the development of the Staggers Rail Act and has commented on and litigated many of the Commission's rules and decisions implementing the Act.

After three years of the Staggers Act, we are dismayed to report that the Act, as implemented and interpreted by the ICC, does not realize the balanced regulatory framework envisioned by Congress. Consequently, the chemical industry urges Congress to begin an amendment process that will ensure that the Commission's decisions are guided by Congressional intent.

We have reached these conclusions not because the philosophy of the Act is unsound. We continue to believe in the Act's philosophy that railroads should be freed from regulation where competition exists, and where the forces of competition are not in operation, the ICC must prohibit the monopoly railroad from extracting unreasonably high rates and otherwise abusing its position to the detriment of captive shippers. Unfortunately, the ICC has not implemented the Act with this philosophy in mind. Instead, the Commission's decisions demonstrate that it believes that railroads should have virtually unbridled pricing flexibility regardless of the extent to which competitive forces exist.

What is even more disturbing is that the ICC has not implemented the Act to maintain existing competition or promote new competition. Despite the policy of the Interstate Commerce Act "to ensure . . . a sound rail transportation system with effective competition among rail carriers," 49 U.S.C. §10101a(4), the Commission has thus far refused to suspend or investigate the railroad's recent wholesale cancellations of joint rates and reciprocal switching agreements. As a result, shippers are left with no effective choice among rail carriers. More and more movements become captive to an individual carrier, and more and more regulation becomes necessary to guard against monopolistic abuse.

The Commission has been able to pervert the philosophy of the Staggers Act because, although the intent of Congress is clear, the Act gives the agency considerable discretion to carry out that intent. For example, many sections simply provide that the ICC "may" prohibit a market abuse if the Commission finds the abuse to be contrary to the "public interest.[1] If we could rely on the Commission to implement the Act as Congress intended it to be implemented, then such broad statutory language would not require correction. But three years' experience has shown us that the Commission is disregarding Congressional intent, as well as elementary economics, in its eagerness to end all meaningful regulatory oversight over rail rates and practices. CMA's suggested amendments, which are Attachment A hereto, would ensure that the Commission's decisions promote rather than frustrate Congress' desire for enhanced rail-to-rail competition.

Before discussing specific problem areas in need of amendment, let us note what we perceive to be the fundamental flaw in the Commission's laissez faire approach to rail regulation. A laissez faire approach might work if a shipper that is being charged an excessive rate by a railroad were able to ship via another railroad or via another mode, such as truck or barge. In the real world, though, such competitive alternatives do not always exist.

Often only one rail track, owned by one carrier, serves a chemical plant or a customer of a chemical manufacturer. Needless to say, a railroad track is much different from a public highway, waterway or airway. In the absence of a special arrangement, another railroad is not free to travel over the owning carrier's track to provide competitive service. As for barge competition, it is feasible only for those plants located on or near waterways; for CMA members only about 10 percent of total chemical traffic moves by barge. Finally, in many instances truck service is not a feasible alternative for chemicals. First, most chemicals move in long-haul shipments for which rail is the only economically feasible alternative. (The average rail move is 588 miles; the average industrial chemical move is 713 miles.) Also, chemical companies have made long-term, multi-million dollar investments in tanks cars and in rail loading facilities which cannot be mothballed at the pricing whims of a market dominant railroad. Thus, many shipments of chemicals are captive to a rail carrier. It is precisely in those situations that the ICC has a legitimate role that it must perform.

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[1] As to the meaning of "public interest," the legislative history of the Staggers Act makes it clear that the ICC: ". . . shall consider as being in the public interest: maximum reliance on competitive market forces and on intramodal and intermodal competition; the avoidance of undue concentrations of market power and the maintenance of protection for shippers against the abuse of market power. . . ." S. Rep. No. 96-470, 96th Cong., 1st Sess. 16 (1979)."

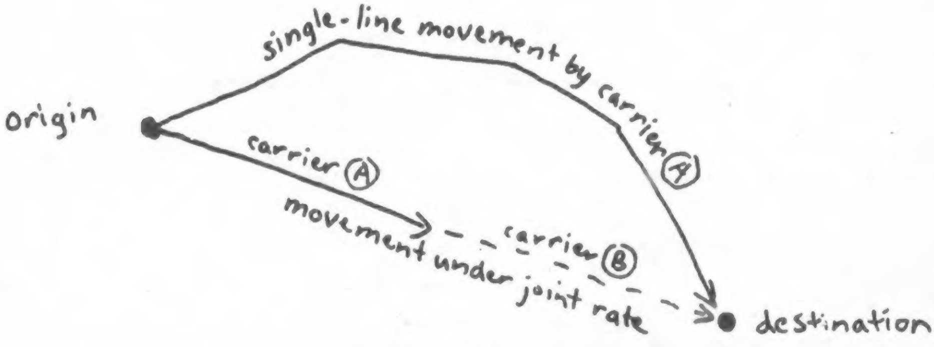
These policies were incorporated into the Staggers Act as passed. See H. R. Conf. Rep. No. 96-1430, 96th Cong., 2d Sess. 88 (1980).

Other groups will explain how the ICC has abdicated its responsibility to protect the captive shipper from unreasonably high rates. Indeed, the Commission's decisions on market dominance, maximum rates, and revenue adequacy amount to little more than elaborate window-dressing for the complete removal of effective restraints on railroad monopoly pricing.[2] Those are critical areas which this Committee should remedy.

In this statement, though, CMA would like to concentrate on how the ICC has abdicated its responsibility to facilitate competition. Of particular concern are the series of recent actions to eliminate competition by cancelling joint rates and reciprocal switching agreements.

JOINT RATE CANCELLATIONS

The effect of a joint rate cancellation on a shipper's competitive choices can best be seen in a diagram:



When Carrier A cancels the joint line rate with Carrier B, and refuses to participate in a through movement either under a reasonable new joint rate or under a combination of reasonable proportional rates, the shipper has no alternative but to use Carrier A's single line service. Carrier A, in effect, has made itself a monopolist over this movement. As such, Carrier A is in a position to extract a higher rate and/or provide more circuitous, delayed service without fear of losing the shipper to a competitor railroad.

Joint rate cancellations may be taken under two sections of the Interstate Commerce Act. Under Section 10705a(c), Section 217 of the Staggers Act, the Commission need only determine that the rate is noncompensatory (i.e., less than 110 percent of variable costs) to permit cancellation. If, however, the joint rate is compensatory (i.e., equal to our greater than 110 percent of variable costs) the Commission is required by Section 10705(e) to determine whether the cancellation is in the public interest, and to specifically consider the greater distance, delays and expense the shipper would bear if the joint rate were cancelled. The Commission has ignored these Section 10705(e) criteria for cancellations of compensatory joint rates. Instead, it has permitted the railroads to eliminate shippers' competitive choices through wholesale concellations of compensatory joint rates.[3]

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[2] This reality was recently acknowledged by ICC Administrative Law Judge James E. Hopkins. In a decision dismissing two rate reasonableness complaints filed by a Michigan electric utility, Judge Hopkins said that the implementation of the Commission's market dominance decisions "will end the usefulness of this Commission to the body of rail shippers," and that further litigation of rail rates appeared pointless "when the policy decision appears to have already been made." No. 37855, Consumers Power Co. v. Norfolk & Western Railway Co., et al. and consolidated case No. 38120S (decision served July 1, 1983), pp. 4, 5.

Whether the joint rate cancellation takes the form of a gateway closing,[4] an elimination of bridge service,[5] or a cancellation as depicted above, the result is the same—all restrain competition from other railroads. The railroads themselves have recognized the blatant anticompetitive purpose and effect of these joint rate cancellations. Consider the statement of William H. Dempsey, President of the Association of American Railroads, before this Committee in 1979:

"One of the problems . . . is the kind of case in which one railroad is a partner in a through route—a joint rate arrangement with another between two points—and has a single line route between those same two points. If that carrier has the unlimited right to cancel the joint rate and establish its own local rate, he could exercise that power in such a fashion as to drive all traffic to the single line route. That, we think, would be an abuse of monopoly power . . "[6]

Similarly, the various railroads that have been cancelled out of joint rate movements have made it clear in their protests to the Commission that the purpose of these cancellations is not to improve efficiency, but to foreclose legitimate competition. For example, the Chicago and North Western called Burlington Northern's system-wide cancellation a "vendetta on competition" that frustrates the benefits of contracts.[7] The Santa Fe described the motives of the Southern Pacific's cancellations as follows: "Here in the guise of cancelling "inefficient [joint] routes" SP is attempting to cancel those routes which are now the principal competition for its own direct routes.[8]

With regard to a gateway closing by the Seaboard System that resulted in the traffic being carried over longer, more circuitous routes of its Family Line affiliates, the Southern Railway said: "Since such action would result in . . . increased cost to the carriers involved and ultimately the public, the gateway closing could not be in the public interest . . .[9]

Likewise, the Chessie System complained of a Conrail joint rate cancellation that "Conrail . . . has taken the extraordinary step of attempting to deprive Chessie of the opportunity to compete for traffic generated by shippers local to Chessie." [10]

Despite the fact that these joint rate cancellations blockout competition, often result in more circuitous routing, and lead to higher transportation rates, the Commission has, for the most part, refused to suspend or investigate the cancellations. Even in the rare case in which the Commission investigated (but approved) a massive cancellation of joint rates (by Conrail), the Commission not only failed properly to consider the anticompetitive nature of the cancellations, but failed even to give shippers an adequate opportunity to present evidence before approving the cancellations.[11]

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[3] See, e.g., Ex Parte No. 445, Standards for Intramodal Rail Competition (unprinted decision denying petition for rulemaking, served July 7, 1983). Chairman Taylor in a separate opinion, at 15-16, points out that the majority's opinion "appears to be signalling a move toward the elimination of any consideration of the specific standards contained in 49 U.S.C. §1075(e)." *See also* the recent decision of the U.S. Court of Appeals for the Seventh Circuit which recognized that Congress' concern for maintaining competition is implicit in section 10705(e) and explicit in the national rail transportation policy of section 10101a. Chesapeake & Ohio Ry. Co. v. United States, Nos. 81-2286, 82-1693 and 82-1625, Slip Op. at 11 (7th Cir. April 4, 1983).

[4] A gateway closing generally refers to the cancellation of a joint rate or rates through an interior gateway location within a carrier's territory such that the traffic must be placed on the cancelling carrier's system at its farthest-out gateway location providing the cancelling carrier a longer and more profitable haul.

[5] When a cancelling carrier eliminates bridge service, it precludes other railroads from providing competitive service on portions of the line-haul movement between the origin leg of the line-haul and the destination leg of the line-haul.

[6] Testimony of William H. Dempsey in Hearings before the Subcommittee on Surface Transportation of the Committee on Commerce, Science and Transportation, United States Senate April 12, 20 and May 22, 1979 (Part 1, Serial No. 96-41), 96th Cong., 1st Sess. 301-302 (1979) (emphasis added).

[7] Protest of Chicago and North Western Transportation Company, suspension Case No. 71046, Verified Statement of C. J. Miller, pp. 1-2.

[8] Protest of the Atchison, Topeka & Santa Fe Railway Company, Suspension Case No. 71026, argument accompanying Verified Statement of F. Wines, at A-2.

[9] Protest of Southern Railway Company in Suspension Case No. 70740, p. 16.

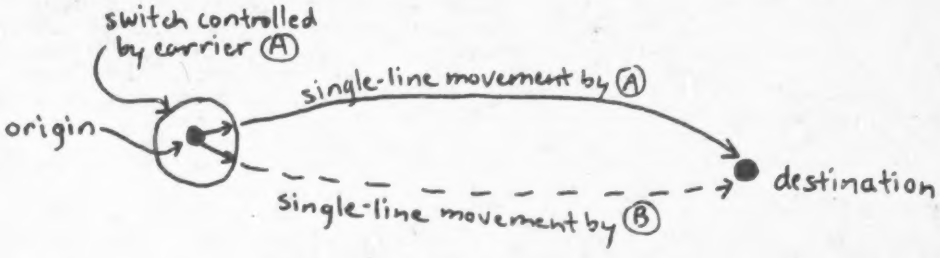
[10] Reply to Protest of Chessie System Railroads, Suspension Case No. 70951, p. 5.

[11] *See* Chesapeake & Ohio Ry. Co. v. United States, Nos. 81-2286, 82-2293 and 82-1625, Slip Op. at 9-11 (7th Cir. April 4, 1983), holding that the Commission's approval of the Conrail cancellations was unlawful.

In Attachment A, CMA suggests amendments to the Act that are essential to curbing the restraints on competition from recent joint rate cancellations. Note that these amendments would continue to permit railroads to freely rid themselves of uneconomical joint rates. The Commission simply would be required: to give protesting parties adequate time to protest mass cancellations, to investigate protested cancellations of compensatory joint rates, and to consider the effects on competition of such cancellations. Furthermore, the cancelling carrier would have to publish a proportional rate (which could be set high enough to be very profitable). The proportional rate would enable other railroads to provide competitive through service to a shipper under a combination of proportional rates. Finally, in a separate "Interchange Competition Amendment", a carrier, upon request, would be required to publish a proportional rate regardless of whether there has been a joint rate cancellation. This would further the intent of the Staggers Act to promote competition in through movements.

ELIMINATION OF RECIPROCAL SWITCHING

A second area in which the Commission has thwarted Congressional intent regards the elimination of reciprocal switching. This refers to the situation depicted below where Carrier A controls the track around the shipper's plant, such that Carrier B can gain access to the traffic only if Carrier A agrees to locally switch the cars onto B's track:



If a reciprocal switching agreement is in effect, the shipper has the option of using Carrier A or Carrier B. What recently has occurred is that carriers that were providing reciprocal switching are filing tariffs that cancel the reciprocal switching agreement, or that raise the price of the reciprocal switch so far in excess of the cost that Carrier B is effectively denied access to the traffic.

Section 223 of the Staggers Act[12] specifically empowers the Commission to order reciprocal switching, and the intent of Congress is clear that the Commission should affirmatively exercise that power. The House Committee on Interstate and Foreign Commerce stated that:

"The Committee intends for the Commission to permit and encourage reciprocal switching as a way to encourage greater competition." H.R. Rep. 96-1035, 96th Cong., 2d Sess. 67 (1980). Similarly, the Conference Committee stated that "[i]n areas where reciprocal switching is feasible, it provides an avenue of relief for shippers where only one railroad provides service and it is inadequate." H.R. Conf. Rep. No. 96-1430, 96th Cong., 2d Sess. 116 (1980).

The Commission has totally disregarded this clear legislative mandate. It has neither required reciprocal switching to take place, nor prohibited it from being cancelled. The abuse of monopoly power is clear; the carrier that controls the switching district limits its competitors by refusing to place the cars onto a competitor's system. As Conrail stated in protesting Chessie's refusal to switch traffic onto Conrail's line: "This sort of a condition is blatantly anticompetitive. The only purpose of such a condition is to . . . stifle intramodal competiton."[13]

And as the Department of Justice stated in the same case: "The Staggers Act makes it clear that the Commission retains jurisdiction to prevent the exercise of monopoly power by rail carriers over captive shippers, particularly when it is manifested by a refusal to switch."[14]

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[12] Codified at 49 U.S.C. § 11103(c)(1).

[13] Protest of Consolidated Rail Corporation, Suspension Case No. 71002, at 1.

[14] Protest of the Department of Justice, Suspension Case No. 71002, at 5.

These protests, and those in every other reciprocal switching case, have fallen on deaf ears. The Commission's misguided interpretation of the Congressional mandate is reflected in a recent reciprocal switch case. There the Commission strongly implied that if the switching carrier is revenue inadequate,[15] that carrier should not open itself up to competition by providing reciprocal switching, but rather should continue to exercise monopoly control over the tariffic.[16]

The amendment suggested by CMA in Attachment A would redirect the Commission tc maintain and promote reciprocal switching agreements that provide competitive service. The carrier that provides the switching service would be fully compensated for the service, and would not have to provide the service if by doing so it would impair its own operations.

A FEW CMA EXAMPLES

Contrary to the Congressional intent "to avoid undue concentrations of market power," 49 U.S.C. § 10101a(13), and "to ensure . . . effective competition among rail carriers" 49 U.S.C. § 10101a(4), these joint route cancellations, gateway closings, and reciprocal switch cancellations have enabled our nation's largest railroads (made larger by mergers) to consolidate their monopolistic control over their dominant territories. Instead of a nationally integrated and competitive rail system, we are ending up with a Balkanized system in which the monopoly carrier in each region can dictate the transportation terms. The Commission is blinded by abstraction if it views these actions as enhancing efficiency.

For example, one CMA member company reports on the problems associated with the Southern Pacific's massive joint rate cancellation/gateway closings and the retaliatory action taken by the Santa Fe that eliminates reciprocal switching onto the Southern Pacific. One of the shipper's products which had been transported from Topeka, Kansas to Los Angeles in six days via the St. Louis Southwestern R.R. and the Southern Pacific must now be transported circuitously in ten days via the St. Louis Southwestern and the Santa Fe or the Union Pacific. This results in a delay to customers, longer holding of inventory, and greater energy consumption.

Another member company reports how these Southern Pacific actions have precluded numerous contracting opportunities, even though it was envisioned that the ICC would implement the Staggers Act to encourage contracting. While this company was negotiating a contract with the Santa Fe for transportation of its product from Eau Claire, Wisconsin to Barstow or Los Angeles, California, for interchange with the Southern Pacific to a Santa Anna destination, the Southern Pacific cancelled all joint rates west of its Kansas City, East St. Louis and Memphis gateways. Now the shipper must ship via the Southern Pacific over its monopoly controlled routes. This costs the shipper on its small volume of traffic approximately $20,000 per year more freight than had the contract been available.

A third member company notes that after one year of operating under a five/year contract, prompted by the Staggers Act contracting freedoms, it was precluded from using the contract by a joint rate cancellation. The cancellation, in effect, ended the joint through movement that was essential to continuation of the contract. As a result, this chemical shipper has become captive to the cancelling carrier, which transports the shipper's cargo at an additional yearly freight cost of $500,000.

CONCLUSION

There are many more examples of anticompetitive rail actions, and many more will occur, unless Congress promptly fine-tunes the Act in such a way that the goal of promoting competition is not undermined by the Commission. The chemical industry urges your consideration of its suggested amendments, and pledges its support for increasing competition in rail transportation.

ATTACHMENT A, JULY 27, 1983

SUGGESTED AMENDMENTS TO THE INTERSTATE COMMERCE ACT TO PROMOTE RAIL-TO-RAIL COMPETITION

The Staggers Rail Act of 1980 was intended by the Congress to maintain and promote intramodal rail competition. The Interstate Commerce Commission, however, has ignored this intent by permitting several major rail carriers to cancel joint rates and reciprocal switching agreements, and by not requiring interchange of traffic. Instead of increasing competition, the Commission's implementation of the Act has led to competition being greatly reduced, as those carriers willing to provide competitive services are refused access to shippers' traffic.

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[15] Under the Commission's definition of "revenue inadequacy," most chemical companies, and most U.S. companies, would be revenue inadequate.

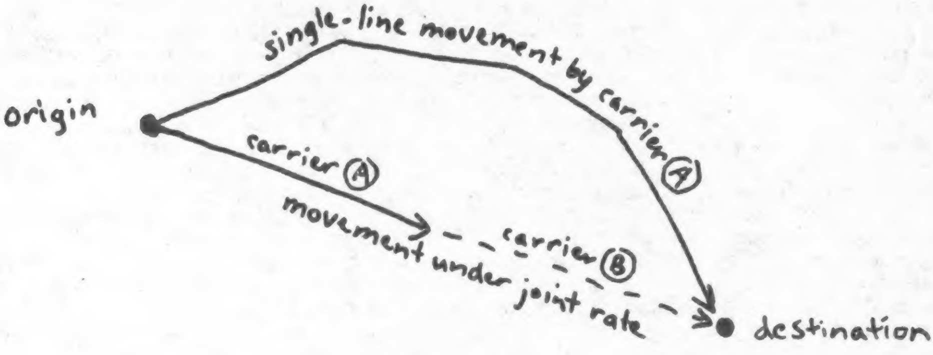
[16] *See Universal Forest Products, Inc.* v. *Seaboard Coast Line,* Fin. Dkt. No. 29883, p. 5 (June 23, 1983).

To rectify the situation, legislation prohibiting anticompetitive cancellations of through routes, joint rates and reciprocal switching, and legislation promoting competitive interchange by requiring publication of proportional rates, are necessary. An explanation of each amendment, with an explanatory diagram and suggested amendment language follow.

I. JOINT RATES

This amendment has several parts. First, the amendment requires the Commission to make determinations, upon complaint by a carrier, shipper or another interested party, of whether a proposed non-compensatory joint rate cancellation is consistent with the public interest. It also makes express what is now an implicit criterion in the public interest determination: consideration of the intramodal competitive effect of the cancellation. In addition, the amendment requires the establishment of proportional rates by a carrier that has cancelled or proposed to cancel a through route or joint rate. The proportial rate would have to be established to the cancelling carrier's point of interchange. This would enable the non-cancelling carrier to continue to participate in the through movement, although it would do so under a combination of proportional rates, not under a joint rate. The proportional rate could not yield a revenue-to-variable-cost ratio higher than the lower of the ratios yielded by (1) a competing single line rate, or (2) the division of a remaining competing joint line rate. This limit on the proportional rate would maintain competition between the through movement and the single-line movement.

This amendment also addresses one of the problems with mass cancellations of joint rates. When these occur, the Commission would be required to extend the time period for protest, so that protesting parties would have adequate time to prepare cases against the numerous cancellations.



Cancellation of joint line rate by A leaves shipper at origin without competitive rail alternative.

Suggested joint rate amendment [1]

A. Section 10705(e) of Title 49, United States Code, is amended by inserting the following sentence at the beginning thereof:

"Upon complaint by a carrier, shipper or other interested party, the Commission shall conduct a proceeding to determine whether a tariff of a rail carrier that would cancel a through route, joint rate, or classification without the consent of all carriers that are parties to it is consistent with the public interest."

B. Section 10705(e) is further amended by striking the word "and" from section 10705(e)(2), striking the period at the end of section 10705(e)(3) and substituting "; and", and adding the following new paragraph:

> *"(4) consider any reduction in intramodal competition and any evidence that such cancellation would unreasonably restrain trade, lead to monopolization, or*

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[1] New statutory language intalicized.

otherwise be anticompetitive, predatory, or designed to eliminate competition from another railroad."

C. Section 10705 of Title 49, United States Code is amended by adding the following new subsection (f):

"(f)(1) When a rail carrier has cancelled or proposed for cancellation a through route or joint rate, upon request of a connecting carrier or affected shipper, such carrier shall establish a proportional rate to its point of interchange which yields a revenue-to-variable cost ratio no higher than the lower of the revenue-to-variable cost ratios yielded by (i) its or an affiliate's competing single line rate or (ii) its or an affiliate's division of a remaining competing joint line rate.

"(2) For purposes of this subsection, 'proportional rate' means a rate which applies exclusively to transportation charges for the services of one carrier to or from an interchange point, which, in combination with a rate of a connecting rail carrier, constitutes a through rate over a through route.

"(3) For the purposes of this subsection, 'affiliate' means any person that directly or indirectly controls, is controlled by, or is under common control with, a particular rail carrier."

D. Subsections (f) through (h) of Section 10705 are redesignated as subsections (g) through (i), respectively.

E. A new Section 10705a(c)(3) is added as follows:

> *"(3) When the tariff will cancel the application of joint rates to multiple through routes, the Commission shall extend the normal time periods for making a demonstration under subsection (b)(2) so that interested parties are given reasonable time in which to make the required demonstration."*

Section 10705a(c)(3) shall be renumbered as 10705a(c)(4).
Section 10705a(c)(4) shall be renumbered as 10705a(c)(5).
Section 10705a(c)(5) shall be renumbered as 10705a(c)(6).
Section 10705a(c)(6) shall be renumbered as 10705a(c)(7).

F. Section 10707(a) of Title 49 of the United States Code is amended by inserting in the first sentence "*, or cancellation thereof,* " after "joint rate."

II. RECIPROCAL SWITCHING

The reciprocal switching amendment addresses both promotion of new reciprocal switching agreements and cancellation of existing agreements.

First, when a carrier desires access to a shipper's traffic, the Commission would require the carrier that controls the reciprocal switch to agree to switch the traffic to the competition if the reciprocal switching agreement is necessary to provide competitive rail service, and does not substantially impair the ability of the carrier that controls the switching service to handle its own traffic. The Commission's action under this amendment would be triggered by a petition by a carrier, a shipper or another interested party. The carrier providing the switching service would be assured full compensation for the service.

The second amendment would add a new subsection addressing the cancellation of reciprocal switching. The Commission would be directed to prohibit the cancellation of a reciprocal agreement unless the agreement is not necessary to provide competitive rail service or substantially impairs the switching carrier's operations. Compensation for the reciprocal switching service could be readjusted if it were not fully compensatory

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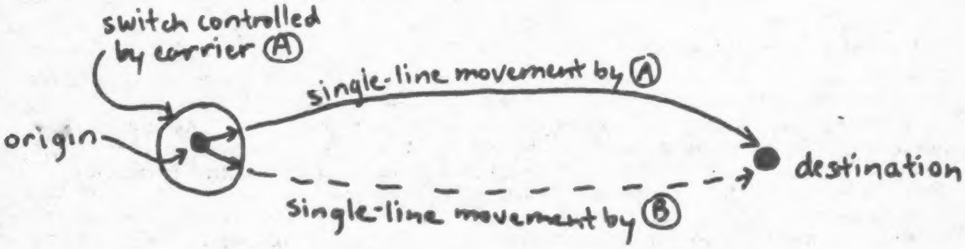

Cancellation of reciprocal switching agreement by A eliminates shipper's competitive alternative.

* * * * * * *

Suggested reciprocal switching amendment

A. Section 11103(c)(1) shall be amended so that the first sentence reads as follows: "(c)(1) *Upon petition by a carrier, shipper or other interested party,* the Commission *shall* require rail carriers to enter into reciprocal switching agreements, where it finds such agreements *are necessary to provide competitive rail service and do not substantially impair the ability of the carrier that owns or operates the switching service to handle its own business.*"

B. A new Section 11103(c)(3) (i) and (ii) of Title 49, United States Code, shall be added as follows:

> *"(3)(i) Upon protest by a carrier, shipper, or other interested party, the Commission shall prohibit cancellation of a reciprocal switching agreement, unless the carrier that is providing the reciprocal switch service demonstrates that the agreement is not necessary to provide competitive rail service or substantially impairs its ability to handle its own businesss.*
>
> *"(ii) If a carrier that is a party to a reciprocal switching agreement files a complaint and demonstrates that a condition of the reciprocal switching agreement is unreasonable or that the compensation is inadequate, the carriers shall establish reasonable conditions and adequate compensation, but if the carriers cannot agree upon such conditions and compensation within a reasonable period of time, the Commission shall promptly establish reasonable conditions and adequate compensation."*

* * * * * * *

III. INTERCHANGE COMPETITION

This amendment is intended to provide competitive rail service where there is no joint rate or proportional rate. In this situation an interested shipper or a railroad offering to provide connecting service could require another carrier to establish a proportional rate to or from an interchange point. As a result, a competitor carrier would gain access to the shipper's traffic at the interchange point, and thus could participate in a competitive through movement using a combination of proportional rates over the through route. The "proportional rate" to be established would have an upper limit: its revenue-to-variable-cost ratio could not exceed the lower of the ratios for (a) the competing single-line rate, or (b) the carrier's division of a competing joint-line rate. This upper limit would ensure competition between the through, movement and the single-line movement.

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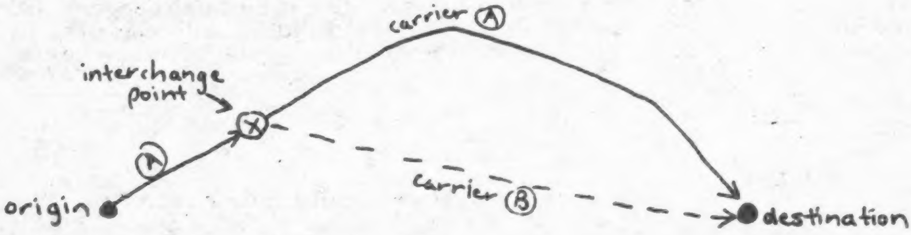

Currently, A's single line rate is the only service; there is neither an A/B joint line rate, nor a proportional rate from the origin to "X". Under the amendment, carrier B or an interested shipper could cause A to establish a rate to "X", thereby establishing an A/B through route with a combination of proportional rates.

* * * * * * *

Suggested interchange competition amendment

Section 10705 of Title 49, United States Code, is amended by adding the following new subsection:

"( )(1) Upon the request of an interested shipper, or a rail carrier offering to provide connecting service to or from a point of interchange, a rail carrier shall establish a proportional rate to that point of interchange. Such rate may not yield a revenue-to-variable cost ratio higher than the lower of the revenue-to-variable cost ratios yielded by (i) its or an affiliate's competing single line rate, or (ii) its or an affiliate's division of a competing joint line rate.

"( )(2) For purposes of this subsection, 'proportional' rate means a rate which applies exclusively to transportation charges for the services of one carrier to or from an interchange point, which, in combination with a rate of a connecting rail carrier, constitutes a through rate over a through route.

"( )(3) For purposes of this subsection, 'affiliate' means any person that directly or indirectly controls, is controlled by, or is under common control with, a particular rail carrier."

NEVADA POWER CO.,
Las Vegas, Nev., August 3, 1983.

Hon. JOHN C. DANFORTH,
Chairman, Senate Subcommittee on Surface Transportation,
Russell Building, Washington, D.C.

DEAR SENATOR DANFORTH: Please accept this as Nevada Power Company's written comments for your consideration in the Oversight Hearings on the ICC's implementation of the Staggers Act.

As pointed out by the position of the shippers testifying before your committee, the ICC promulgated and proposed regulations under the Staggers Act has exacerbated the already difficult position of captive shippers, especially captive coal shippers such as Nevada Power Company. Members of the committee during their questioning of shippers, railroad representatives and representatives of the ICC and federal railroad administration demonstrated that the ICC is implementing and enforcing regulations in ways never anticipated, considered or intended by the Congressional sponsors of the Staggers Act. Thus, the only position regarding the Staggers Act that any individual can accept is that the Staggers Act is flawed and should be repealed in its entirety.

Prior to the Staggers Act or any enforcement of the Staggers Act, Union Pacific was allowed to charge rates well above those which could be considered reasonable. With implementation of the Staggers Act and the present ICC philosophy regarding "revenue adequacy" for railroads, we can anticipate not only the continuing of the unreasonably high railroad tariffs, but increases beyond that. The more than 200,000 electric power consumers in Southern Nevada will be paying to support an unreasonably high rate of return of investment for the Union Pacific Railroad. As the supplier of electric power for those consumers, we ask the Congress of the United States to provide legislation to protect those consumers through protection of the captive coal shippers. At the Committees' request or the request of the Committees' staff, we will submit the records and data to support our position that:

(1) Existing coal shipping tariffs are excessive and unreasonable;

(2) The ICC is allowing the railroads to take advantage of the captive shipper; and

(3) The captive shipper, and in this case the electric utility coal shipper and its customers, can only receive protection by repeal of the Staggers Act and "re-regulation" of the railroads.

Sincerely,

CHARLES A. LENZIE.

THE AMERICAN SHORT LINE RAILROAD ASSOCIATION,
Washington, D.C., August, 5, 1983.

Hon. JOHN C. DANFORTH,
Chairman, Subcommittee on Surface Transportation,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: These comments are for the record of your Oversight Hearings on The Staggers Rail Act of 1980, held July 26-27, 1983, and are submitted on behalf of the 265 small railroad members [1] of this Association.

The Association was active in the legislative process that culminated in passage of The Staggers Act in 1980, and we endorsed that bill because of several safeguards to assure the continued vitality of small railroads in a deregulated environment. Unfortunately, those safeguards have fallen short of the mark in certain areas.

We wish to add our support to those who have voiced criticism of the Interstate Commerce Commission's recent decision in Ex Parte No. 346 (Sub-No. 8), Exemption from Regulation—Boxcar Traffic, served May 2, 1983. This Association, along with approximately 200 other carriers, shippers, and associations, participated in this proceeding before the Commission and presented evidence that a proposal of this scope was both inappropriate for consideration under the exemption criteria of 49 U.S.C. 10505 and would be extremely harmful to small railroads and the shippers they serve. In spite of this, majority of the Commission concluded otherwise and approved it effective November 7, 1983. They did this in spite of the fact that they recognized this action would, indeed, be harmful to small carriers, but contrary to their optimism that somehow everything would work out, there is in reality no basis to assume that the problems which even they found, will satisfactorily resolved through negotiation or the passage of time. The reason is simple: a small Class III carrier typically connects with only one other railroad—a large Class I carrier. This small carrier—whose average length is approximately 28 miles—has very little to bring to the bargaining table that the Commission's majority foresaw as the happy conclusion to its saga. And lacking any semblence of equality at the bargaining table, such a small carrier faces the prospect that its boxcars and the traffic moved in them will be handled in the future—if at all—only under terms dictated by the large carrier. This, for most small railroads, is not happy prospect.

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[1] Except carriers operated by Delaware Otsego Corp.

We are continuing our opposition to this ruling both at the Commission and in the Courts, but with the membership of the Commission unchanged from that at the time the decision was made, there appears little reason to expect any relief there unless the Congress takes immediate action to overturn this unwarranted and unjustified edict.

We also wish to call attention to the Commission's failure to implement the so-called Lee Amendment (subsections (i), (j) and (k) to 49 U.S.C. 10705a), which was designed to assist small Class III railroads in combating unfair route cancellations and surcharges on joint rates. Today, nearly three years after The Staggers Act was signed into law, in not one instance has the Commission exercised its authority under those subsections and accorded any protection to a protesting small railroad. In what is surely one of the saddest demonstrations of its insensitivity to the mandate of The Staggers Act, the Commission recently announced its intention to dismiss as moot one of those proceedings [2] where two small railroads sought relief from the agency under the terms of the Lee Amendment; when relief was not forthcoming, the carriers appealed to Federal Court, which remanded the case for further consideration, but now that these carriers have been driven out of business by the very route cancellations to which they were objecting, the Commission has conveniently chosen to shove the matter under the rug, so to speak.

In bringing deregulation to the railroad industry, it is clear that the Congress recognized the abuse that could result to small entities from the unfettered application of new regulatory freedoms by large railroads, and moreover, that it took steps to curb this abuse. All we ask is that the Congress direct the Commission to carry out its INTENT.

Sincerely,

THOMAS C. DORSEY.

THE ALUMINUM ASSOCIATION, INC.,
Washington, D.C., August 5, 1983.

Hon. JOHN C. DANFORTH,
Chairman, Subcommittee on Surface Transportation, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of the Aluminum Association, Inc., we request that our statement be made part of the official record of the Oversight hearings on the Staggers Rail Act of the Subcommittee on Surface Transportation.

As major shippers of aluminum products by rail, our member companies are directly affected by the decisions of the Interstate Commerce Commission in interpreting and implementing the Staggers Rail Act. The Commission's ruling on such issues as market dominance and maximum reasonable rates have led us to believe that the Act is not being administered as the Congress intended. Further, the Commission's decisions on route closings and cancellation of joint rates have not led to the ultimate purpose of the Staggers Act—the promotion of greater competition.

We hope that the Subcommittee's consideration during the oversight process will lead members to conclude that legislation is needed to address problems that currently exist with the Commission's administration of the Staggers Act.

Thank you for your consideration.

Sincerely,

M. BARRY MEYER,
Senior Vice President.

Enclosure.

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[2] No. 38679, Restructured Rates on Recyclables, O/T Iron or Steel Scrap, Conrail, served July 27, 1983.

STATEMENT OF THE ALUMINUM ASSOCIATION, INC.

Mr. Chairman, my name is Dickson R. Loos and I am transportation counsel for The Aluminum Association, Inc. ("Association") with headquarters in Washington, D.C. The Association represents the aluminum industry in traffic and transportation matters generally and its members account for 100 percent of the production of primary aluminum metal and over 80 percent of the semifabricated products manufactured in the United States. We had the privilege of appearing before the Senate Committee several years ago when transportation legislation, which evolved as the Staggers Rail Act of 1980, was first considered. We welcome this opportunity to appear before the Committee and give our views on how the Staggers Act has been working over the past two years.

At the outset, let me make it clear that the members of the aluminum industry do not favor a return to strict regulation of the transportation industry. There is no doubt that passage of the Staggers Act has fostered greater flexibility and greater efficiency in transportation and the railroads are in a sound financial position. These are all good things and we applaud the efforts of Congress in coming up with this bold, fresh approach to surface transportation. In fact, when the dust settled down on September 29, 1980, most carriers and shippers alike thought we had a pretty good package.

Our problem is that we do not believe that the Commission is administering the Act in the manner that Congress intended. The two major problems are the definition of market dominance and the proper interpretation and implementation of a maximum reasonable rate.

The legislative history of the Staggers Act is revealing. As the Committee is aware, the original bill introduced before the Senate, S. 796, proposed sweeping deregulation in that shippers were required to show that there were no alternatives, or additional sources, for the commodity as shipped. The provisions of S. 796 would have made it impossible to prove the existence of market dominance and thus there would be virtually no protection at all for captive shippers. The Senate did not adopt S. 796 and a new bill sponsored by Senators Cannon, Long and Packwood was subsequently adopted by the Senate (S. 1946) which was responsive to the need for regulatory protection for captive traffic. In the House, H.R. 7235 was clearly a deregulation bill with no protection for captive shippers. Maximum rate regulation, however, was introduced by an amendment through Congressmen Eckhardt and Rahall. Again, the House rejected the concept that product or geographic competition must be considered in order to prove market dominance. As a result, the Staggers Act of 1980 made no changes in the definition of market dominance (49 U.S.C. § 10709(a)) and the definition remains "an absence of effective competition from other carriers or modes of transportation for the transportation to which a rate applies." That, however, is not how the Commission construes the concept of market dominance.

Perhaps no other industry has been subjected to as extreme a definition of market dominance as the aluminum industry in Docket No. 37466, *The Aluminum Association, Inc., et al.* v. *Akron C. & Y. Ry. Co., et al.* In July of 1981, the aluminum industry received an initial decision finding that market dominance under the Staggers Act was present and that rates charged on aluminum moving from the Pacific Northwest to destinations in the South, Midwest and East were unreasonable. An administrative appeal was filed by the railroads. Under the Interstate Commerce Act, the Interstate Commerce Commission was required to decide the appeal prior to June 14, 1982. The Commission, however, refused to decide the case and the Aluminum Association was required to go to the Federal District Court to get a Mandamus Order requiring the Commission to decide the case. On June 8, 1983 responding to the Court's order, the Commission issued a decision reversing the administrative law judge and holding that market dominance did not exist even though freight rates on aluminum ingot averaged over 220 percent of variable costs and, in some instances, exceeded 250 percent of cost. Moreover, over 90 percent of the shipments moved by rail in spite of the high rates and the undisputed testimony was that plants in the Pacific Northwest were not constructed to permit any large volume of traffic to move by truck. The decision was so extreme that another administrative law judge, holding that the application of the Aluminum Association decision "will end the usefulness of this Commission to the body of rail shippers", dismissed two pending coal cases. (Docket No. 37857, *Consumers Power Co.* v. *Norfolk & W. Ry. Co.*; Docket No. 38120, *Consumers Power Co.* v. *Chesapeake & O. Ry. Co.*). The judge reasoned that it was a needless waste of time and energy to continue the cases since the Commission's policy would preclude a favorable decision for the shipper. (See attached article from Traffic World of July 11, 1983.)

Obviously, The Aluminum Association is appealing the Commission's adverse ruling. However, there is a limited amount the Court of Appeals can do on judicial review of the Commission's decisions. Endless delays, appeals, and remands back to the Commission have made rate litigation so expensive and time consuming that it no longer is an adequate remedy to protect captive shippers in spite of regular reversals by the appellate courts.

Another aspect of the Staggers Act which has concerned shippers is the development of standards for rate reasonableness. The Staggers Act now provides guidelines which would vastly simplify the process of determining a reasonable rate. We believe that the structure of the Staggers Act was intended to be a three tiered regulatory statute. The jurisdictional threshold (now 170 percent of variable cost) was the regulatory floor. Anything below that level was not subject to maximum rate jurisdiction. The second layer extends from the jurisdictional floor (170 percent) and rises 20 points to 190 percent. In this zone, the Commission may exercise jurisdiction if it finds market dominance exists. In this range, however, the rates are presumed to be reasonable and it is up to the shipper to demonstrate that such rates are unreasonable. The third level extends form 190 percent (20 points above 170 percent) upward. Here again the Commission's jurisdiction is based on finding market dominance. If that finding is made, then the shipper is considered to have made a prima facia case for unreasonableness where it demonstrates rates exceed 190 percent of variable costs and it is up to the carrier to come forward with evidence justifying rates at such a level.

Under these guidelines the burden of proof remains upon the shipper in a complaint case but the shipper has made his case if he shows the rates are above 190 percent. The duty of going forward with the evidence then shifts back to the railroads to justify rates at those levels. This is precisely the findings made by the administrative law judge in Docket No. 37466 (The Aluminum Association case) and is the procedural rule adopted by at least one state in the Ex Parte No. 388 certification proceedings whereby the states must file rules which indicate that intrastate rate matters will be decided using compatible policies with the Federal Act.

Consequently, captive shippers thought they had a workable solution to their problem, but it has not worked out that way. To resolve these problems, Senator Ford has introduced legislation in S. 1082 and Congressman Rahall has introduced companion legislation in the House (H.R. 2584). The purpose of this legislation is not to change the Staggers Act but only to implement it. It takes away much of the discretion from the Commission. In effect, it will change the Commission's function with respect to market dominance and rate reasonableness considerations from a body with wide regulatory authority to more of a fact finding body with explicit legislative directions regarding the ultimate findings which must be made.

Senator Ford's bill addresses both of the issues most critical to captive shippers. Section 2 clarifies the language of the Act making it clear that the rail carriers have the duty to justify reasonableness of rates over 190 percent. As pointed out earlier, I believe this is what the Act means now, but the Commission is paying no attention to the guidelines. Instead, the Commission has proposed to apply the Coal Rate Guidelines (Ex Parte No. 347 Sub. No. 1) which called for "constraint" pricing. Without going into unnecessary detail, it is obvious to everyone that three of the constraints, providing that the carriers can only introduce rate increases of 15 percent per year in excess of the allowed inflationary increases, that the so-called Long/Cannon factors must be considered by revenue adequate carriers, and that shippers should not be charged with an obvious railroad management inefficiency, are all without substance. Clearly, the Commission has no intention of ever finding railroad management decisions are obviously inefficient and it is highly unlikely that the Commission will ever find any railroad to be "revenue adequate". Holding increases to 15 percent per year does nothing to hold the maximum rate down but only prolongs the full application to the captive shipper. The fourth constraint—stand alone cost rates—are really the only constraint the Commission has proposed and it is so high when applied to most classes of traffic that it acts as an encouragement for even higher rates rather than a constraint.

To understand how stand alone costing works, I have attached a memorandum of the Bureau of Accounts of the Interstate Commerce Commission dated December 21, 1981. One of the regular volume movements of aluminum ingot involved in Docket No. 37466 is from the State of Washington to Iowa, a distance of a little over 2,000 miles. The annual volume is approximately 120,000 tons. A glance at the tables attached to the memorandum shows that stand alone rates for an annual volume of 500,000 tons moving 1,500 miles would exceed 1,100 percent of variable cost, using the L&N Railroad characteristics, and 1,800 percent using characteristics of the

Union Pacific Railroad. No doubt if the tables were extended to include 100,000 ton annual volumes and 2,000 mile hauls, the stand alone rates would approach or exceed 3,000 percent of variable cost. As pointed out in the memorandum, these are rough figures and not intended to be accurate. However, the magnitude of the rates that the Commission is considering shows that the stand alone rate is no constraint at all and yet this is the concept the Commission is looking at—not the Staggers Act guidelines.

With respect to market dominance, section 5 of Senator Ford's bill (S. 1082) reestablishes the presumptions of market dominance which the Commission promulgated long ago when the market dominance provisions were first enacted. The only substantive change is to convert them into conclusive presumptions, thus removing any discretion from the Commission. As the Committee is well aware, the Staggers Act did not change the definition of market dominance at all. The Commission, however, has changed and they revoked the previously established rebuttable presumptions and published a new series of regulations just as if the market dominance definition had ben changed by the original bills introduced in 1979 which did not pass.

Section 5 of the bill also restricts the use of the exemption powers which are used more and more frequently by the Commission to deregulate all transportation. Under this provision, the Commission could no longer exempt any transportation from regulation unless there is a finding of no market dominance. The Commission's recent decisions in the Boxcar Deregulation case (Ex Parte No. 346, Sub. No. 8) and the Export Coal cases (Ex Parte No. 346, Sub. No. 7) point up the necessity to pass this provision.

Another aspect of the implementation of the Staggers Act deserves comment. One of the main purposes of the Staggers Act was to promote competition. This was to be the ultimate regulator of freight rates. However, there is less competition now—not more. The Commission has permitted a great number of route closings and cancellations of joint rates. The discretionary power to order reciprocal switching and joint use of terminal facilities in 49 U.S.C. 11103 is rarely, if ever, used. Mergers of large railroads into huge systems has cut down on intra-modal competition.

Thus, shippers now have less alternatives than before. Often they are forced to use circuitous and inefficient routes so that the origin line can maximize the hands on the lines of its system. We are clearly in favor of greater competition and support proposals which would make it mandatory to provide reciprocal service and joint use of terminal facilities thereby enabling shippers to have access to more than one railroad.

Mr. Chairman, we firmly believe that there is such a thing as captive shippers and captive traffic. Rail transportation remains the most cost efficient and fuel efficient form of land transportation. In the Association's aluminum ingot case (Docket No. 37466) it was stipulated that rail transportation is four times more fuel efficient than motor carriers. It is not in the public interest to adopt a distribution system tied to a mode which uses substantially greater quantities of fuel. It is in the public interest to promote rail transportation and it is not always true that the rail industry is so enlightened that it will reduce rates even when some of the traffic may be forced to motor carriers. In our case, the railroads now have over 90% of the traffic. The answer we frequently hear to requests for reduced rates is "why should we"? Without some rate protection, it is a hard one to answer. The railroads have most of our business now at the current rates. Under the Commission's recent ruling, our chances for reduced rates are slim and a realistic appraisal is that we must anticipate even higher rates in the future unless that decision is set aside judicially or legislatively.

In conclusion, let me thank the Committee for the opportunity to present the aluminum industry's views on the implementation of the Staggers Act. We urge Congress to take a look at how it is being administered. We do not think it is being done the way it was intended and the few adjustments proposed in Senator Ford's bill seem to us to be an appropriate way to resolve the problems.

Attachments.

INITIAL DECISIONS: JUDGE CITES "NEEDLESS" RAIL RATE LITIGATION

ICC Administrative Law Judge James E. Hopkins has sounded a warning that shippers are wasting their time and money complaining to the ICC that railroad freight rates they pay are too high.

Dismissing two complaints by Consumers Power Co. against rates various railroads charge it to haul coal from mines in eastern Kentucky to its plant at Erie, Mich., Judge Hopkins said the competitiveness of the market precludes the ICC from ruling on the reasonableness of the rates at issue, but he added that pursuing the issue of reasonableness would be fruitless anyway because the Commission's policy on rail rates would preclude a favorable decision for Consumers Power.

Citing a recent Commission ruling that several railroads do not have a monopoly over the bulk of the nation's aluminum ingot traffic, the judge said that decision and its expected application to other complaints "will end the usefulness of this Commission to the body of rail shippers."

Judge Hopkins said there was no reason to force Consumers and the defendant railroads to continue litigating the cases (No. 37857S, *Consumers Power Co. v. Norfolk & Western Railway Co., et al.*, and No. 38120S, *Consumers Power Co. v. the Chesapeake & Ohio Railway Co., et al.)* "when the policy decision appears to have already been made."

INTERSTATE COMMERCE COMMISSION MEMORANDUM, DECEMBER 21, 1982

To: Commissioners' staff members.
From: Ronald S. Young, Director, Bureau of Accounts.

During the staff briefing held October 22, 1982 on Ex Parte No. 347 (Sub. No. 1), "Maximum Coal Rate Guidelines—Nationwide," a number of individuals requested data on the range of revenue-variable cost ratios which could result from our proposed formulation of stand-alone costs. Attached are hypothetical stand-alone costs for Union Pacific and Louisville and Nashville data. Across the top of the matrix are various annual volumes for stand-alone shipper(s); down the left side are various mileage blocks. The costs for each element of the matrix were developed using the methodology described in the draft decision for the prima facie showing only. That is, the major track accounts are restated on a depreciated current cost bassis and assigned totally to the stand-alone volume; but no adjustments for optimal plant size were made, as would occur in an actual case before the Commission. The consequence of this limitation is that the revenue-cost percentages for the extreme volumes are biased. For these annual volumes, our prima facie data of "plant in place" overstates or understates what is necessary to provide service efficiently (minimum long-run average cost) and the revenue-cost percentages are substantially above what would result if the appropriate adjustments for plant size were made.

MEMORANDUM TO COMMISSIONERS' STAFF MEMBERS FROM WILLIAM F. MOSS

For example, the Union Pacific costs were based on double mainline track. Thus, actual stand-alone cost for low volume movements may be less than what is shown for the prima facie case. However, without specific facts, we were reluctant to make any adjustments. Rather than speculate on the types of cost adjustments which could be made, we identified what we believe is the "relevant range" of volumes and movements at the prima facie investment level. We believe these volumes and distances would utilize approximatley the same quantity of investment which is in place. The "relevant range" for each carrier is identified by the marked area.

The "relevant range" for the two illustrated carriers differ because of variances in the plant size and operating characteristics. The Louisville & Nashville is primarily a single mainline road, with relatively short hauls (not exceeding approximately 800 miles). Thus, its "relevant range" reflects the smaller capacity and shorter haul. As noted, the Union Pacific is primarily double line and has hauls approaching 1500 miles. Accordingly, we have moved the "relevant range" toward the higher densities and longer hauls.

I stress once again that the data shown is hypothetical and that the "relevant range" is based on our judgement.

Because stand-alone cost calculations are fairly complex, I will have a briefing on how the costs for the Union Pacifice and Louisville and Nashville Railroads were derived. My secretary will contact you to set up a briefing date for next week.

If you have any questions, please call me.

Attachments.

STANDALONE COSTING SIMULATION FOR A TYPICAL UNION PACIFIC TRAINLOAD MOVEMENT AT VARIOUS MILEAGES AND LINE SEGMENT TRAFFIC DENSITIES

Miles/annual volume (tons)	Ratio of stand alone rate to variable cost							
	500K	1,000K	5,000K	10,000K	20,000K	50,000K	70,000K	90,000K
50	1,119	640	256	208	185	170	168	166
100	1,396	777	282	220	190	171	168	165
150	1,527	843	295	227	193	172	168	166
200	1,603	881	302	230	194	172	168	165
300	1,689	923	310	233	195	172	168	165
500	1,762	959	317	236	196	172	168	165
750	1,806	981	321	239	197	172	168	165
1,000	1,827	992	323	239	198	172	168	165
1,250	1,841	998	324	240	198	172	168	165
1,500	1,850	1,003	326	241	198	172	168	165

STAND ALONE COSTING SIMULATION FOR A TYPICAL LOUISVILLE & NASHVILLE TRAINLOAD MOVEMENT AT VARIOUS MILEAGES AND LINE SEGMENT TRAFFIC DENSITIES

Miles/annual volume (tons)	Ratios of stand alone rate to variable cost							
	500K	1,000K	5,000K	10,000K	20,000K	50,000K	70,000K	90,000K
50	766	456	209	178	161	153	151	150
100	903	522	218	179	160	148	147	145
150	969	555	223	181	160	147	146	144
200	1,003	571	225	182	160	147	145	143
300	1,044	591	228	183	160	146	144	142
500	1,078	607	230	183	159	145	143	141
750	1,095	615	231	183	159	145	142	140
1,000	1,105	620	232	183	159	145	142	140
1,250	1,110	622	232	183	159	145	142	140
1,500	1,115	625	233	183	159	145	142	140

Southern Hardwood Traffic Association,
Memphis, Tenn., August 8, 1983.

Hon. John C. Danforth,
Chairman, Surface Transportation Subcommittee, Senate Commerce, Science, and Transportation Committee, U.S. Senate, Washington, D.C.

Dear Senator Danforth: Southern Hardwood Traffic Association (SHTA), organized in 1911, incorporated and existing under the laws of the State of Tennessee, is a quasi-trade association serving the transportation and traffic management interests of its dues paying members, each engaged in some facet of the lumber and forest products industry, and scattered throughout 31 States and the Province of Alberta, Canada. We now have 212 members.

Since its inception in 1911, SHTA's members have generally been rail oriented. Many of them would still prefer to use rail transportation; however, during the past 15 or 20 years, the hauling of logs, lumber and basic lumber material and related wood products have been shifting progressively from the railroads to the motor carriers. In many instances, the railroads simply could not or were not willing to meet the competition of the motor carriers to retain or recover the tonnage being lost to the motor carriers. Although many of the rights and privileges of the railroads to take independent action and to meet this competition were available to them prior to the Staggers Rail Act of 1980 (SRA) and SHTA representing mostly small or medium sized firms, was opposed to the elimination of antitrust immunity for collective ratemaking by the railroads, hence immunity to shippers and shipper associations, and we are still convinced that this is a much more economical way of making and maintaining a system of freight rates for a network of rail transportation companies where at least 70% of all traffic must be interchanged between two or more carriers, there were members of SHTA who welcomed the reduction of government intervention in the rail transportation and welcomed the alleged competition which the railroads would encounter when the marketplace became the regulator instead of federal agencies.

The railroads, the Department of Transportation, the Carter Administration and others advocated deregulation of the railroads as a means of greatly reducing the cost of transportation to the shipping public. The railroads sought freedom from regulation "so that they could participate in the marketplace just like any other industry", many of their top management people said. "The railroads are four times as fuel-efficient as the motor carriers. We want to compete in the marketplace and to be able to set our prices, raise and lower them, like any other industry", many of the railroad spokesmen advocated.

Since the enactment of this legislation, SHTA has been an active participant in many of the Interstate Commission proceedings which followed, as an implementation of the SRA. During the time when the deregulation of the railroads was being advocated up to and following its enactment in October of 1980, the lumber and forest products industry was encountering one of the most severe recessions in business since the great depression in the early 1930's. Many other industries were encountering similar experiences. We have advocated, as well as many others, including members of SHTA, that the true effects of the SRA on the shipping public and their costs of transportation have not been felt, nor can they be measured adequately and indiscriminately until such time as the economy returns to the normalcy of the late 1970's.

In other words, the evaluation which your Committee is endeavoring to make of the SRA, following the oversight hearings and additional comment, cannot be true and correct as long as the experiences that we have had prior to and since the enactment of the SRA have been abnormal. In other words, in am abnormal economy such as we have had during the past three years, we are going to experience abnormal reactions and results in an experiment such as the SRA.

In analyzing the provisions of the Rail Transportation Policy, 49 USC, Section 10101a as added by the Staggers Rail Act of 1980, Section 101 of Title I, we note that it is the policy of the U.S. government, on the one hand:

"(1) To allow, to the maximum extent possible, competition and the demand for services to establish reasonable rates for transportation by rail", whereas, on the other hand, another provision, "(3) To promote a safe and efficient rail transportation system by *allowing* rail carriers to *earn adequate revenues, as determined by the Interstate Commerce Commission*" (emphasis supplied), would nullify or destroy the initiative to compete, one rail carrier with another, one rail carrier with another mode of transportation, because the ICC will determine what the railroads need as "adequate revenues" and authorize them to pass them on to the shipping public in the form of quarterly cost recovery increases.

I note, for example that the ICC, on August 4, served its decision in Ex Parte 436, Railroad Cost of Capital—1982, wherein it noted that a composite cost of capital for 1982 was 17.7%, based on procedures and standards established in its Ex Parte 393 proceeding, Standards for Railroad Revenue Adequacy. If the railroads want to be treated like any other industry and be able to compete in the marketplace, why must they be protected by establishing "adequate revenue levels", "rail cost adjustment factors" and a "zone of rate flexibility", 49 U.S.C., Section 10707a, also added by the SRA, Section 203 of Title II. We know of no other industry that has such guarantees from the U.S. government no matter how large the company is and certainly the companies which we represent have no guarantee of their protection as to cost of capital and revenue adequacy, etc. If the railroads are going to compete in the marketplace, then these guarantees built in by the U.S. government and promulgated by ICC proceedings should be eliminated.

Another provision of the New Rail Transportation Policy, "(10), To encourage honest and efficient management of railroads and, in particular, the elimination of non-compensatory rates for rail transportation", sounds good. We are all for efficiency and honesty in government or in any enterprise, but we do not find any implementing provisions of the SRA or Ex Parte proceedings initiated by the ICC to set up any standards for measuring efficiency among carriers and we are inclined to believe than when the costs of management and labor for operating a railroad or compared to the management costs and labor costs for operating other giant industries, such as RCA or General Motors, etc., the railroads might not be as cost efficient as we are led to believe. Why should they be so cost efficient if they have provisions in the Act to assure them of adequate revenues and "a return on investment" and coverage of their cost of capital, etc?

Another provision of the Rail Transportation Policy, "(13) To prohibit predatory pricing and practices, to avoid undue concentrations of market power and to prohibit unlawful discrimination", also sounds good but the shipping public, and small shippers such as SHTA represents, have little or no practical way of standing the burden of proof before the ICC or before a Court as to predatory pricing and practices by the carriers or unlawful discrimination, for that part. SHTA, on several occasions, has petitioned the ICC to suspend and investigate rail carriers' cancellations of joint rates and routes, the elimination of gateways, etc., and in every case, the petitions were denied and the tariff provisions of the railroads allowed to become effective. The latest was that of ConRail in I&S 71080, Supplement 2 to Freight Tariff ICC CR 9330-E. This had to do with circumventing the obligations of the bill of lading contract which has so long been the standard for doing business with railroads, truck lines, freight forwarders, etc.

Insofar as proving unlawful discrimination, how can a shipper prove that a rail carrier, by the establishment of contracts under 49 U.S.C. 10713, a new Section added as a result of Section 208 of Title II of the SRA of 1980, the terms of which are confidential to the parties, except for a cursory examination by the Interstate Commerce Commission, has not engaged in predatory pricing or discrimination against other shippers with like products, circumstances and capabilities? If the provisions for establishing contracts do not promote a concentration of market power, we do not understand the term.

Another example of concentrations of market power is the establishment by a merged rail transportation system of per car rates or charges applicable only for movements handled by that one rail system over its single line route where industries at origin or destination are either served by that ratemaking railroad or the industries are open to reciprocal switching. Shippers at other points, which have previously competed on mileage rates where the most distant point bears a higher charge than the other shipper now find themselves unable to compete because of the lower rates or charges where a single line controls the entire transportation and their joint rate and route provisions of the past, while still available, are of no avail. Not only are the shippers prevented from participating in former markets, but railroads which have participated in movements for joint line application now find that they no longer can participate because the single line carrier refused to negotiate the same or even similar reductions in rates. Some carriers, in order to retaliate against this single line restriction, have closed their industries to reciprocal switching, thus forcing the single line carrier to either negotiate a joint rate with the carrier serving the industry or accepting a combination rate over some local point of the connecting line, thus depriving both carriers of lowest revenue which could be obtained through joint rates and routes.

49 USC, Section 10505, "Authority to Exempt Rail Carrier Transportation", Section 213 of Title II of the SRA, gave the ICC permissive authority to exempt transportation that it deemed unnecessary to carry out the Transportation Policy or is not needed to protect shippers from the abuse of market power. Trailer-on-flat-car and container-on-flat-car traffic have thus been made exempt from all regulations by the ICC. It has been our observation that this exemption has resulted in rail carriers competing with each other for movements that normally were handled in boxcar movements and are now moving TOFC or COFC while motor carriers, that are still regulated, must compete with this traffic with the unregulated railroads. When we examine some of the rate or charges which the railroads offer the third parties, the shippers agents or consolidators, who then, in turn, retail the TOFC and COFC transportation to the consumers, we question how the railroads can cost justify the rates which they apparently are granting these third parties under confidential contracts. These are all areas that are above reproach through the Interstate Commerce Commission because of these provisions of the SRA.

Finally, we would like to comment on the changes made by the SRA, Section 402 of Title IV, as to abandonment proceedings. The relief granted the railroads under these provisions, together with later Acts such as the Northeast Rail Services Act of 1981, making it easier and faster for rail lines to abandon unprofitable segments of their tracks, have caused our members much anxiety and undue hardships. Reiterating the fact that the last three years have been extremely detrimental for the lumber and forest products industry means that shipments that formerly moved by rail have been reduced to truckload quantities with the demand for faster delivery and a faster turnover of money and the rail lines, except for some time limitations, have little or no acceptable opposition from shippers, States or municipalities to prevent abandonment at will. We feel that the railroads eventually are going to rue the day that they have eliminated so much of their tracks where future business may be available.

In conclusion, we respectfully ask, on behalf of SHTA and its involved members, that you give due consideration to the experiences and comments concerning certain provisions of the Staggers Rail Act of 1980, that we have tried to honestly and forthrightly detail for you, and that they be taken into consideration in dealing with new or corrective legislative measures.

Respectfully submitted.

PAUL T. MCQUISTON,
Executive Vice President.

SEARS, ROEBUCK & CO.,
Chicago, Ill., August 12, 1983.

Hon. BOB PACKWOOD,
Chairman, Subcommittee on Surface Transportation,
Washington, D.C.

DEAR CHAIRMAN PACKWOOD: On behalf of Sears, Roebuck and Co., I would like to offer these comments for the record of the oversight hearings of the Subcommittee on Surface Transportation on the Staggers Rail Act.

Sears, Roebuck and Co., headquartered in Chicago, Illinois, is the world's largest retailer of general merchandise, including soft goods, home furnishings, heavy merchandise and appliances. We distribute broad lines of goods through approximately 3,700 retail and catalog locations as well as operating a mail order service direct to customers. The various buying departments of Sears purchase merchandise from more than 6,000 domestic suppliers as well as sources outside the United States.

Sears' annual transportation costs, of all types, are approximately $850,000,000 and approximately 15 percent of this amount is applied to rail transportation.

Sears as a substantial user of rail transportation has a keen interest in a strong rail system. We supported enactment of the Railroad Revitalization and Regulatory Reform Act of 1976, and the Staggers Rail Act of 1980.

These Acts provide a transition time for transportation to adapt from a regulated industry, swaddled in the cocoon-like protection of the I.C.C., to a marketplace in which competition will be the predominant factor.

For retailing, the transition began in the late 1970's, when under the 1976 Rail ("4-R") Act nonmarket dominant, i.e., competitive traffic was removed from I.C.C. maximum rate powers. This effectively closed the I.C.C.'s door in virtually all cases involving maximum piggyback and boxcar rates on merchandise movements.

The Staggers Act removed substantially more railroad traffic from I.C.C. maximum rate authority and legitimatized railroad contract rates under the antitrust laws.

The 1980 Staggers Rail Act also gave the I.C.C. broad exemption powers. Early in 1981, the Commission exercised this power to deregulate piggyback traffic. For most retailers, piggyback is by far the largest portion of their rail movements. This piggyback exemption order removed in one stroke almost 90 years of regulated tariffs, collective price action, and all I.C.C. minimum and maximum rate powers.

Piggyback is now being bought and sold in the marketplace, subject to the antitrust laws, as are other goods and services.

Since the enactment of the Staggers Act, Sears itself, and through its shipping association membership, has entered into 21 rail transportation contracts. These contracts, and piggyback deregulation have enabled us to reach bilateral agreements beneficial to both ourselves and the carriers with respect to rates and service.

The major rail mergers since the Staggers Act—the Union Pacific-Missouri Pacific-Western Pacific; Norfolk Western-Southern; Burlington Northern-Frisco; and C & O/B & O-S.C.L. are part of an evolutionary process towards fewer-and-fewer individual railroads and major rail systems. The survival of the rail transportation industry, under private ownership, dictates this course of merger.

Further, the evolution of a transportation system combining some form of truck and rail to accomplish the total transportation function will create considerable opportunities for flexibility.

As for the reservations raised about the lessening of competition as a result of rail mergers and intermodal-rail ownership, there are ample regular route, irregular route and contract motor carriers—as well as private carriage—to provide competitive pressures.

Delaying enactment of expanded deregulation in railroad markets will subject both shippers and rail carriers to constantly changing regulatory agency dictates.

We start with the premise that the best system for business, including the transportation business, is the competitive marketplace.

Therefore, rather than turn back the clock, we would urge the prompt elimination of all I.C.C. rail entry, exit, and antitrust immunity; and, maximum rate regulation, after a transition period to allow competition to become effective. We believe Congress should fix the date when market forces and antitrust laws will be substituted for all I.C.C. rail regulation to complete the transition.

We believe that Congress should also promptly address the question of whether the I.C.C. should continue beyond its own hundredth anniversary in 1987.

Greater freedom from unnecessary governmental restraints is essential to the revitalization of a strong, privately-owned rail transportation system.

I respectfully request that this letter be made part of the record of the Staggers Rail Act Oversight Hearings.

Sincerely,

George F. Tidmarsh,
Vice President,
Operating and Distribution.